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# THE ADMINISTRATION'S BUDGET PROPOSAL FOR THE SBA FOR FISCAL YEAR 1991

## HEARING

BEFORE THE

## COMMITTEE ON SMALL BUSINESS
## UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

THE ADMINISTRATION'S PROPOSED BUDGET FOR THE SBA AND REAUTHORIZATION OF THE AGENCY'S PROGRAMS

## Part 1

MARCH 8, 1990

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# THE ADMINISTRATION'S PROPOSED BUDGET FOR THE SBA AND REAUTHORIZATION OF THE AGENCY'S PROGRAMS

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THURSDAY, MARCH 8, 1990

U.S. Senate,
Committee on Small Business,
*Washington, DC.*

The Committee met, pursuant to notice, at 2:08 p.m. in room 428A, Russell Senate Office Building, Hon. Dale Bumpers (Chairman of the Committee) presiding.

## STATEMENT OF HON. DALE BUMPERS, A U.S. SENATOR FROM THE STATE OF ARKANSAS

The Chairman. Susan, welcome to the Committee this afternoon.

Ms. Engeleiter. Thank you, Mr. Chairman.

The Chairman. Today, we begin our first in a series of hearings which will lay the groundwork for reauthorization of Small Business Administration programs.

Today's hearing focuses on the President's budget proposals for fiscal year 1991, and on the status of the Small Business Administration business lending programs. Senator Nunn will later Chair a hearing on the Small Business Development Center Program and I will Chair a hearing on the Disaster Program.

We also plan to conduct an oversight hearing on the 8(a) Minority Business Development Program in the next few months.

Technically speaking, SBA is authorized under existing law for the next fiscal year. The authorization, however, provides no specific program levels for 1991 and was drafted so that the House Appropriations Committee could proceed with its work in the event that we on the authorizing Committees have not completed our work. This is not an oversight on the part of Chairman LaFalce or me. In 1988, my intention was to keep problematic questions open for 1991 so that the new Administration would have an opportunity to review existing programs and propose changes or additional programs. These hearings are for that opportunity.

I am pleased to welcome Ms. Engeleiter, our Administrator. She has been in office for almost a year and I look forward to hearing a progress report on her first year in office, as well as her priorities for the remainder of the Bush Administration. Inspector General Charles Gillum will testify following Ms. Engeleiter.

With respect to the budget proposal, it is certainly more positive than those submitted by President Reagan. For the first time in 4 years no asset sales are proposed, thus recognizing the Appropriations Committee's long-standing prohibition on sales of income-producing loans.

There are, however, a number of warmed over Reaganisms, such as drastically increased loan guarantee fees. The 150 percent increase in the Section 7(a) loan guarantee fee from two points to five has drawn little or no support among this Committee. In short, Ms. Engeleiter, that is a nonstarter.

The increases for SBIC debentures from 1.185 to 5 percent is even more radical and coupled with a cut in the SBIC Program from $246 million to $100 million, it makes me wonder if the SBIC owners have all left the Republican Party—I did not write that, my staff wrote that. They are a lot harder to get along with than I am.

Likewise, the elimination of our meager, Direct Loan Program for the handicapped and Vietnam-era veterans are unkind cuts.

I remain concerned about some of the proposed increases and user fees for small business. While I am not opposed to such fees in circumstances where a person receives a unique and valuable benefit from a program, such as perhaps the 8(a) Program, I doubt these fees should be imposed where they are likely to deter significant numbers of firms from program participation.

I have several questions of the Administrator and for Inspector General Gillum about both the budget proposal and about several areas of ongoing concern and specific SBA programs.

Senator Boschwitz is not here, and so I will now turn to Senator Lott for an opening statement if the Senator has one.

## STATEMENT OF HON. TRENT LOTT, A U.S. SENATOR FROM THE STATE OF MISSISSIPPI

Senator Lott. Thank you, Mr. Chairman. I will be brief.

I do have a few questions I would like to ask in a few moments, but first I would just like to welcome Ms. Engeleiter here. I think she is doing an excellent job as the Administrator for the Small Business Administration, and I think she has proven that administration can be improved while providing more efficient program delivery. I know you have just been in the position a relatively short while, but you have increased my positive feelings about SBA.

I want to congratulate you for being accessible and available, not only to Members of Congress, but to the media. I think you are doing a good job in that area. I have been very impressed with the quality of the people that you have brought in, and in some instances that you tried and did not quite work out. I do believe that you are doing some things to streamline the approach and that is being helpful.

I am one that has had a lot of reservations about the Small Business Administration in recent years. Some people said it was not on the right track. I wondered if it was on any tracks at all. My small businessmen and women in Mississippi were saying: What SBA? They just were not doing enough.

I was particularly concerned about the accessibility and availability of the SBA for minorities. I have been very disturbed about, I thought, the insensitivity to the 8(a) Program, particularly in my State, the poorest State in the Nation, but I think you are making progress in all of those areas, and I congratulate you for what you have done so far. I will have some tougher questions when I get my opportunity, but we are glad to have you here.

The CHAIRMAN. Thank you Senator Lott.

Ms. Engeleiter, please feel free to proceed with your testimony.

## STATEMENT OF SUSAN ENGELEITER, ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY LAWRENCE ROSENBAUM, COMPTROLLER, SBA

Ms. ENGELEITER. Thank you very much, Mr. Chairman, and thank you very much Senator Lott for those comments. It is an honor to appear before you again as I near the completion of my first year as the Administrator of the U.S. Small Business Administration. I am particularly pleased to come before the Committee in this new era of the Agency's 37-year history, an era represented by President Bush's strong commitment to a renewed and a revitalized SBA.

I would like to thank you and your colleagues for the assistance and the support that you have given all of us at the Small Business Administration since my arrival.

I believe that we at the SBA have one of the best teams in place in all of Government. One member of that team accompanying me here today, is our Agency's Comptroller, Lawrence Rosenbaum, who has been with the Agency for 23 years.

Mr. Chairman, I have submitted a rather lengthy statement today and, with your permission, I would like to summarize that and then answer questions, if that is all right with you.

The CHAIRMAN. That would be most welcome. I have read your statement and I am sure Senator Lott has too.

Ms. ENGELEITER. I am sure all the other Members have as well, so that will save some time.

As we begin deliberations on the Small Business Administration's fiscal year 1991 budget, the United States small business sector remains extremely dynamic. During the first 9 months of 1989, more than 520,000 new corporations were formed in the United States, and 98 percent of those were small businesses. At the same time, business failures declined 15.6 percent from the first 9 months of 1988 to 1989. The fiscal year 1991 budget will allow the Small Business Administration to continue serving small enterprises and to encourage the continued creation of more firms and more jobs.

During my tenure as Administrator, the Agency's work will be guided by a number of goals that have been formulated in a comprehensive process that solicited input from program professionals, industry and trade group representatives, Members of Congress and general practitioners in the small business community. These general goals are to: Improve the SBA's program delivery; improve the Agency's outreach; ensure equal access and opportunity for all Americans, including minority and women entrepreneurs; and lastly, to improve the management and administration of the Agency to prevent waste, fraud, and abuse.

Mr. Chairman, we will be announcing in the next 4 to 6 weeks, very specific objectives in all program areas of the SBA in order to meet these goals which we have developed for the rest of President Bush's term.

Our fiscal year 1991 budget requests $5.6 billion for SBA's credit programs and $337 million for noncredit programs and administrative expenses. The credit budget of $5.6 billion includes $3.8 billion for direct and guaranteed loans, $1.5 billion for surety bond assistance, and $285 million for direct disaster loans.

The largest part of the credit budget, as you know, is the $3.2 billion for the 7(a) General Business Guarantee Program. The SBA's fiscal year 1991 budget request includes a strong commitment to the 7(a) Loan Guarantee Program, by requesting a funding level consistent with the 1990 appropriations for that particular program. Based on the first 4 months of this fiscal year, we project that there is sufficient lending authority to meet the demand for this assistance around the country.

This budget proposes substantial assistance for the venture capital needs of small businesses as well, including minority businesses, through the Small Business Investment Companies.

We have just completed a major review of the SBIC liquidation process. This review included how we value the portfolio, liquidate the assets, and charge-off loans. We are seeking new ways to reduce the Federal Government's exposure to losses in this particular program. We are updating our procedure manuals, closing-out inactive cases, developing better procedures for valuing assets, creating liquidation plans for individual cases, and improving management information and record-keeping systems. We are hiring additional staff to provide better oversight of the SBIC portfolio.

The fiscal year 1991 specialized SBIC or minority investment companies budget request is for $80 million in guarantee authority, and would replace the fiscal year 1990 budget of $31 million in direct assistance and $49 million in guarantee authority. Under the 1991 request, the interest rate for this program would be subsidized at 3 percentage points below the Treasury's cost of borrowing for the first 5 years of the 10-year debentures issued by the specialized SBICs.

This guarantee initiative, as you know, was congressionally authorized in the fiscal year 1990 appropriation. As a result of that legislation, SSBICs, the minority investment companies, will be allowed to sell their debentures through the SBIC funding corporation, an arrangement previously limited to the regular SBIC Program. I am pleased to let you know that this statutorily required change will be implemented in this month's SBIC funding, truly allowing those SSBICs, as they are called, to leverage their funds and to help more minority small firms get equity financing.

Our budget request also includes an increase in the surety bond guarantee authority to $1.5 billion. This represents a $250 million increase over the appropriated level for fiscal year 1990. Surety bonding is clearly one of the needs of many small businesses that is not being adequately met in the private sector throughout the country, and especially for those people who are in the construction industry. The SBA continues its commitment to making the bonding process accessible to small and emerging contractors, including those that are owned by minorities and women who find bonding sometimes difficult to obtain.

As you know, recent legislation has authorized the SBA to establish a Pilot Program to encourage the larger surety companies to help provide surety bonds to small businesses. The SBA has notified the surety bonding community that we are ready to accept their participation in this new, Preferred Surety Bond Program. The final regulations for this program have been completed and are at the Office of Management and Budget.

In fiscal year 1989, SBA's Office of Procurement Assistance saved the Federal Government more than $280 million through its Breakout and Certification of Competency programs. This office will be expanded through this fiscal year 1991 budget request.

By calling for the appropriation of funds for an additional 30 procurement positions, the budget reflects the Bush Administration's commitment to increasing small businesses share of Federal procurement dollars. The cost of these positions will be more than offset by the savings generated through the SBA's Procurement Assistance Program.

Thanks to the action of Congress, SBA's Disaster Program, I am pleased to report, has more than adequate loan-making authority in our revolving fund account to handle last year's disasters, including two sizeable disasters, Hurricane Hugo and the Loma Prieta or California earthquake. We are requesting loanmaking authority for fiscal year 1991 in the amount of $285 million. We believe this amount should be adequate to meet the expected obligations of what we hope will be an average disaster year.

To put our Disaster Program into perspective for you, recently the Agency made its one millionth disaster loan since the program started. The SBA has disbursed over $12 billion in disaster loans since the inception of the agency in 1953.

Finally, Mr. Chairman, with respect to our financial programs, we request that all direct business loans in the amount of $77 million be converted to guaranteed loans, with the exception of our Disaster Loan Program and the $5 million for the Section 8(a) Loan Program, which Congress passed and President Bush signed into law on November 15, 1988.

The phase-out of direct lending in favor of guaranteed lending is part of a governmentwide initiative. Direct Loan Programs are more costly to administer and often result in larger losses to the Federal Government. In addition, guaranteed lending benefits the borrower substantially by allowing him or her to establish a track record with a private lender, which will assist the borrower in their future credit needs. Guaranteed loans are also more beneficial to the Government because they allow us to serve more small businesses and more small business clients by leveraging the resources.

In an effort to move toward actuarially sound programs and to offset the default costs that SBA incurs, we propose to increase the guarantee fees on business loans. I realize that is not a popular proposal, investment company loans and minority investment company loans. This proposal meets the long range goals of a governmentwide program to transfer the cost of Federal programs from the general taxpayer to the direct recipient of program benefits, and to make the programs more self-sufficient.

Our proposal would increase the guarantee fee on business loans from 2 percent to 5 percent. Small Business Investment Company loans would be increased from 1.2 percent to 5 percent. The Specialized SBIC or MESBIC Program would be increased from 1.2 percent to 3 percent. We do not expect the fee increases to have a dramatic adverse effect on the programs.

To give you an example, Mr. Chairman, the fee increase that we are proposing in the 7(a) Program would raise the monthly payments on the average 7(a) loan that the Agency is now making, by a nominal $75 a month.

Finally, as you indicated, Mr. Chairman, the credit budget submission does not include proposals for any asset sales.

The second major part of our fiscal year 1991 budget submission covers the Agency's request for a direct appropriation of $337 million to the Salaries and Expenses fund. This appropriation will finance all of the salaries and related expenses of the Agency and its noncredit programs. Among the noncredit programs are the Small Business Development Centers, the Small Business Institutes on 600 campuses around the country, the Service Corps of Retired Executives, and the Section 7(j) Program, which offers 8(a) minority firms and other minority firms technical and management assistance.

We are proposing to increase SBA's current authorized employment level by 61 full-time equivalent positions. These additional positions will be used in high-priority areas, such as procurement assistance, SBIC servicing, and minority- and women-owned business programs. This increase also includes a request for the Office of Inspector General to assist in their efforts to prevent waste, fraud, and abuse.

In the noncredit programs, we propose to nominally increase existing user fees by $1 million. These fees would be generated equally from the sale of business development publications and services provided through the Procurement Automated Source System or PASS.

It is appropriate, also, to recognize our budgetary support for the National Minority Business Development Commission by including $865,000 for its operations in fiscal year 1991, an increase from this year's amount of $493,000.

The budget submission contains $500,000 to continue the work of the National Women's Business Council. Last year, I was very honored to be appointed by President Bush to chair that council. The council held its first meeting in January and has established four general goals, much of them through the direction of H.R. 5050. The council will focus on data collection, credit, and bonding issues, international trade or exporting opportunities for women-owned businesses and procurement opportunities at the State, local, and Federal levels.

The Women's Business Ownership Act of 1988 created a new Demonstration Grant Training Program for women entrepreneurs and authorized $10 million for this program over 3 years: fiscal years 1989, 1990, and 1991. Congress appropriated $2 million for the programs in each of the fiscal years 1989 and 1990. The fiscal year 1991 submission proposes $5 million.

Mr. Chairman, the SBA is working with the small business community and other agencies to assist small firms in exporting. The SBA's export revolving line of credit, or ERLC as we call it, is generally a short-term loan of no longer than 18 months and is used to finance materials and labor to be used in the export process.

The maximum amount of this loan was increased from $500,000 to $750,000 by the Omnibus Trade Act of 1988. The program provided $10.5 million in capital for small exporters in fiscal year 1989, in addition to $26.2 million that was provided by the Agency to exporters under the SBA 7(a) General Business Guaranteed Loan Program.

As we all know, some areas of rural America have not shared in the prosperity of our Nation's record economic expansion in recent years. In support of the President's Rural Initiative, which was announced by the White House on January 22, we announced on January 24, a 13-point initiative for SBA to focus more effectively on rural economic development. Under our new rural initiative, SBA will identify areas that are underserved by our traditional programs and take steps to target those programs much more successfully in those areas.

I am pleased to report to you today that the Small Business Innovative Research Program has, since its inception in 1982, awarded in excess of 15,000 funding agreements to direct a share of Federal research and development funds to small high-tech companies around the country—the type of companies which are responsible for the majority of the Nation's new products, processes and technologies.

I recently submitted to Congress a notification of our intent to elevate the Office of Innovation, Research and Technology within the Agency, and allow SBIR, as it is called, to be treated on an equal footing with the Agency's other key programs.

Current SBA studies clearly indicate the remarkable commercialization potential of the technologies being developed under SBIR. It presently appears that over 20 percent of the SBIR projects are going to the commercial marketplace. The SBIR program, as you know, is currently authorized only through fiscal year 1993.

The Agency's Small Business Development Center Program has received tremendous support at the State and local levels. Estimates by the Association of SBDCs are that for every dollar of Federal money that is now put into that program, at least $1.50 is being put up by State, local, and private entities. For the current fiscal year, there will be $50 million of federal funds, and roughly $75 million of State, local, and private funds in the SBDC program. And I would add that by the end of this year, we expect that program to be up and running in all 50 States.

We expect that this leveraging of Federal dollars will increase in amount and increase in proportion in the future. In fact, because of this tremendous success, we propose that the SBDC Program become independent from Federal funding by the end of fiscal year 1992. To accomplish this objective, we are asking for $30 million in Federal funds for fiscal year 1991 and $15 million for fiscal year 1992.

And finally, the fiscal year 1991 budget includes requests for several management initiatives. A one-time request of $4.2 million is for the relocation and consolidation of our Washington central office. These offices are currently housed in six different locations here in Washington. The move will take approximately 6 months, and during that time, we will be required to pay dual rent to GSA and must also cover other associated relocation expenses.

Our budget also includes a request of $3.5 million to replace our outdated, mainframe computer. Both of these initiatives are well under way and on target with scheduled completion dates.

Mr. Chairman and Members of the Committee, we are ever mindful of the President's pledge to maintain a strong and healthy economy, conducive to the prosperity of small businesses. That commitment to small business was reiterated in the President's State of the Union Address, in his noting that we, and I quote, "Encourage risk takers, especially those in our small businesses, to take those steps that translate into economic reward, jobs and a better life for all of us."

We at the SBA believe the President's budget to be a good-news budget and a reflection of this Nation's commitment to the small businessmen and small businesswomen who contribute so much to our economy and to the opportunities inherent in this great land.

Thank you very much, Mr. Chairman. I have included, as you noted, in my longer statement, significantly longer comments in regard to five program areas that you were interested in having me address, and I would be glad to elaborate on any of those in the questions that you have for me.

[The prepared statement of Ms. Engeleiter follows:]

SBA U.S. Small Business Administration Washington, DC 20416

Statement of
Susan Engeleiter
Administrator
U.S. Small Business Administration
Before the
Committee on Small Business
United States Senate
March 8, 1990

Mr. Chairman and distinguished Members of the Committee:

It is an honor to appear before you again as I near the completion of my first year as Administrator of the U.S. Small Business Administration. I am particularly pleased to come before the Committee in this new era of the Agency's 37-year - old history - an era represented by President Bush's strong commitment to a renewed and revitalized SBA. I want to thank you and your colleagues for the assistance and support you have given the SBA since my arrival. I believe that we have one of the best teams in all of government. One member of that team, accompanying me today is the Agency's Comptroller, Lawrence R. Rosenbaum.

As we begin deliberations on the Small Business Administration's Fiscal Year 1991 Budget, the United States small business sector remains very dynamic. During the first nine months of 1989, more than 520,000 new corporations were formed, 98 percent of which were small businesses. At the same time, business failures declined 15.6 percent from the first nine months of 1988.

The FY 1991 budget will allow the SBA to continue serving those new, small enterprises and encourage the continued creation of more firms and more jobs. During my tenure as Administrator, this work will be guided by a number of goals formulated in a comprehensive process that solicited input from program professionals, industry and trade group representatives, and general practitioners in the small business community. These goals are to:

--- Improve SBA's program delivery, including the elimination of red tape in the administration of the Agency's programs.

--- Improve the Agency's outreach in an aggressive effort to make small business aware of the assistance SBA can provide.

--- Ensure equal access and opportunity for all Americans, including minority and women entrepreneurs, so they will be able to compete on an equal footing in the U.S. economy.

--- Improve the management and administration of the Agency to prevent waste, fraud and abuse.

Our FY 1991 budget requests $5.6 billion for SBA's "credit" programs and $337 million for non-credit programs and administrative expenses. The "credit" budget of $5.6 billion includes $3.8 billion for direct and guaranteed loans, $1.5 billion for surety bond assistance, and $285 million for direct disaster loans. The largest part of the "credit" budget is the $3.2 billion for the 7(a) general business loan guaranty program.

The SBA's FY 1991 budget request includes a strong commitment to our 7(a) loan guaranty program, by requesting funding at a level consistent with 1990 appropriations for the program. The Bush Administration believes this level of funding will help address the small business community's healthy demand for loans. We also believe that it will adequately fund several new guaranty programs added in recent years through legislation.

You have asked me to discuss SBA's loan portfolio and its health. As of January 31, 1990, SBA's total loan portfolio includes

245,911 loans worth $16.6 billion. Of these, 168,522 loans worth $5.6 billion are the result of direct SBA financing. This portfolio includes loans made through our business loan programs -- 7(a), Certified Development Companies, Small Business Investment Companies (SBICs), disaster assistance, as well as direct lending to veterans, the handicapped, and 8(a) firms. Since 1953, SBA's loan programs have resulted in more than $58 billion in funding to America's small businesses.

We are continuing to implement policies to improve the quality of our loan portfolio. In 1982, SBA launched its Quality Lending Program. This Program is designed to improve all SBA lending and is based upon a philosophy in loan processing which emphasizes quality rather than numerical goals. As a result of that initiative, the SBA today requires from its borrowers a more clear picture of their ability to repay their loans.

As of January 31, 1990, the 7(a) general business loan guaranty program accounted for $7.9 billion of SBA's loan portfolio, with 66,383 loans outstanding. It is important to note that within the 7(a) general business loan program 16 percent of all loans are provided to minority-owned-firms and 14 percent are directed toward women-owned-firms. The dollars loaned to small businesses through the 7(a) program come from SBA's lending partners, primarily commercial banks around the country. From 1953 to date, the total cumulative loss rate on 7(a) business loans is 8.2 percent of the total amount disbursed. However, this rate does not include anticipated losses from repurchased guarantees that are still in the Agency' liquidation portfolio. The ultimate loss rate for the 7(a) program, including recoveries on the liquidation portfolio, currently is 12.7 percent.

Based on the method used by commercial banks, SBA's loss rate in the 7(a) program appears more favorably. The latest loss rates reported by the FDIC show that in 1987 the loss rate on commercial loans by banks were approximately 1.2 percent. SBA's FY 1989 loss rate based upon the same method is 3.3 percent. This figure shows an improvement over previous years, when losses averaged just under 4 percent. In the disaster loan program, the FY 1989 loss rate is slightly higher, 3.9 percent. The difference between the commercial banks' loss rates and SBA's loss rates are not significant when one recognizes SBA's mission as the "lender of last resort" to small business.

The 1991 budget proposes substantial assistance to the venture capital needs of small businesses, including minority businesses, through the Small Business Investment Companies (SBICs). We have just completed a major review of the SBICs liquidation process. This review included how we value the portfolio, liquidate the assets, and "charge off" loans. We are seeking new ways to reduce the Federal Government's exposure to losses. We are updating our procedures manuals, closing out inactive cases, developing better procedures for valuing assets, creating liquidation plans for individual cases, and improving management information and recordkeeping systems. We are hiring additional staff to provide better oversight of the portfolio.

As you know, our Specialized SBIC program has been of great assistance to start-up and growing business ventures owned by socially or economically disadvantaged Americans. The FY 1991 budget request for an $80-million guaranty authority would replace the FY 1990 budget of $31 million in direct assistance and $49 million in guaranty authority. Under the 1991 request, the interest rate for this program would be subsidized at 3 percent below the Treasury's cost of borrowing for the first five years of ten year debentures issued by specialized SBICs.

This "guaranty" initiative was congressionally mandated in the FY

1990 appropriation. As a result of that legislation, SSBICs will be allowed to sell their debentures through the SBIC Funding Corporation, an arrangement previously limited to regular SBICs. I am proud to say that this statutorily-required change will be implemented in this month's SBIC funding, truly allowing SSBICs to leverage their funds.

Our budget request also includes an increase in surety bond guarantee authority to $1.5 billion. This represents a $250 million increase in authority over the appropriated authority for FY 1990. Surety bonding is clearly one of the needs of many businesses, especially those in the construction industry. The SBA continues its commitment to make the bonding process accessible to small and emerging contractors, including minorities and women, who find bonding unavailable to them.

As you know, legislation has mandated that SBA establish a pilot program to encourage the larger surety companies to help provide surety bonds to small businesses. The SBA has notified the surety bonding community that we are ready to accept their participation in this new Preferred Surety Bond program. The final regulations for this program have now been completed.

In recognition of the growing importance of surety bonding assistance to small business, SBA has begun upgrading its surety program. A reorganization meant to elevate the importance of the surety program is pending. Also, we have announced a nationwide search for a new Director for the program.

In FY 1989, SBA's Office of Procurement Assistance saved the Federal Government more than $280 million through its Breakout and Certificate of Competency programs. This office will be expanded through this FY 1991 budget request. By calling for the appropriation of funds for an additional 30 procurement positions, this budget reflects the Bush Administration's commitment to increasing small business' share of federal procurement dollars. The cost of these positions will be more than offset by the savings generated through SBA's Procurement Assistance programs.

As you are aware, the Business Opportunity Development Reform Act of 1988
became law on November 15, 1988. That statute mandated positive changes in the 8(a) program by calling for a greater emphasis on the business development aspects of the program and an increase in the number and diversity of participating firms. The law also took appropriate steps to ensure that program benefits accrue only to eligible individuals and businesses.

SBA published final regulations to implement the statute on August 21, 1989. When I was sworn in as SBA's Administrator last

May, the public comment period for SBA's proposed implementing regulations had just closed, and the Agency was in the process of reviewing more than 300 comments received during this period. The final 8(a) program regulations published on August 21, 1989, represent a significant revision to the proposed regulations and reflect the goals of making 8(a) program criteria less subjective and providing equal access to program benefits for all eligible individuals and firms.

I am pleased, Mr. Chairman, to report today on the noteworthy progress that we have now made in our continuing efforts to implement this very complex legislation and the myriad programmatic changes it mandated.

In accordance with the provisions of the statute, on January 16, 1990, SBA began operations in its 10 Division of Program Certification and Eligibility field offices located in SBA's regional offices. In addition, concurrent with the establishment of the Division, we have prepared, printed in bulk and distributed for field use, the new 8(a) application forms mandated by the Business Opportunity Development Reform Act of 1988 (Public Law 100-656).

Pursuant to the statutory mandate to emphasize the business development nature of the program, during the past year, we have held 20 sessions to provide training to more than 500 agency employees. Training has included orientation on the new Business Plan form, financial analysis training, and intensive program eligibility instruction for the new COD staffs.

We have also taken steps to implement the statutory mandate that manufacturing contracts in excess of $5 million, and contracts in excess of $3 million in all other industries, be awarded through competition among eligible 8(a) firms instead of by sole source. To date, we have accepted 40 procurement opportunities worth over $200 million for the 8(a) competitive process.

Finally, we have taken steps to implement special provisions of the Act relating to 8(a) program applications and participants that are owned by Indian Tribes. To assure that this implementation process continues appropriately, SBA has established and staffed a position within its Office of General Counsel to coordinate Native American issues within the Agency.

Mr. Chairman, in a relatively short time, SBA is well on its way to implementing all the new provisions of Public Law 100-656. I am very proud of the Agency's accomplishments in achieving this difficult task. As well, it is appropriate to recognize our support for the Minority Business Development Commission by including $865,000 for its operations in FY 1991--an increase from this year's amount of $493,000.

Thanks to the action of the Congress, the disaster program has more than adequate loan-making authority in our revolving fund account to handle last year's disasters, including two sizable disasters, Hurricane Hugo and the Loma Prieta earthquake. We are requesting loan making authority for FY 1991 in the amount of $285 million. We believe this amount should be adequate to meet expected obligations of an "average" disaster year. Moreover, our fund balance will continue to grow as we receive repayments from the large loan volume disbursed in FY 1990.

To put our disaster activity into perspective, let me mention the Agency's involvement in recovery efforts after Hurricane Hugo and the Loma Prieta earthquake. To respond to the magnitude of these two disasters, SBA expanded its disaster staff from 325 to 1,550.

Through February, 1990, SBA had received 66,557 loan applications. We have verified losses in 92 percent of these cases and we've completed action in 71 percent of the cases. We have approved 27,847 loans for a total of more than $550 million. We estimate that between $650 and $750 million will be provided to assist victims of the hurricane and earthquake disasters.

And, we have reached a milestone in our disaster assistance program: recently, we made our one millionth disaster loan. The SBA has disbursed $12 billion in disaster loans since the inception of the Agency in 1953.

Mr. Chairman, I would like to acknowledge the tremendous efforts of our field and central office personnel who did an extraordinary job during a season of unprecedented disasters. Our staff has received many compliments from the leaders of the affected communities and states.

The purpose behind all SBA credit programs is to provide credit to those who cannot obtain it on the open market. This concept should also guide our disaster loan program. Therefore, we propose to restructure the program, providing loans only to those individuals who cannot obtain credit in the private markets. For those individuals, we will continue to provide the necessary financing at the Treasury cost of borrowing.

Finally, Mr. Chairman, with respect to our financial programs we request that all direct business loans, in the amount of $77 million, be converted to guaranteed loans, with the exception of our disaster assistance program and the $5 million for the section 8(a) loan program which the Congress passed and President Bush signed into law on June 15, 1989. The phase out of direct lending in favor of guaranteed lending is part of a government-wide initiative. Direct loan programs are more costly to administer and can result in larger losses to the Federal Government. In addition, guaranteed lending benefits the borrower by establishing a track record with a private lender, which will assist the borrower in its future credit needs.

Guaranteed loans are also more beneficial to the government because they allow us to serve more small business clients by leveraging resources. Also, to move towards actuarially-sound programs and to offset default costs that SBA incurs, we propose to increase the guaranty fees on business loans, investment company loans, and minority investment company loans. This proposal meets the goals of a long-range, government-wide program to transfer the cost of federal programs from the general taxpayer to the direct recipients of program benefits, and to make the programs more self-sufficient. The budget proposals of other Executive Branch agencies, such as the Departments of Transportation, Labor, and Agriculture also include fees to offset the cost of doing business.

Our proposal would increase the guaranty fee on business loans from 2 to 5 percent. Small Business Investment Company loans would be increased from 1.2 to 5 percent. The Specialized SBICs or "MESBICs" program would be increased from 1.2 to 3 percent. We do not expect the fee increase to have an adverse effect on the programs. For example, the fee increase in the 7(a) program would raise the monthly payments on the average loan by a nominal $75.

Also, we propose a modest fee of .06 percent on 7(a) general business loan secondary market transactions. This proposal is in line with other agencies, such as HUD, that currently sell FHA loans through the Government National Mortgage Association in the secondary market with a similar fee attached. This fee is designed to insure against potential losses from the additional

Federal guaranty on the timely payment of principal and interest to investors in the secondary market program.

The second major part of our FY 1991 budget submission covers the Agency's request for a direct appropriation of $337 million to the Salaries and Expenses fund. This appropriation will finance all of the salaries and related expenses of the Agency, including its non-credit programs. Among the non-credit programs are the Small Business Development Centers (SBDC) program, Small Business Institutes, the Service Corps of Retired Executives, and the Section 7(j) program, which offers 8(a) firms and other minorities technical and management assistance.

We are proposing to increase SBA's current authorized employment level by 61 full-time equivalent positions. These additional positions will be used in high priority areas such as procurement assistance, SBIC servicing, and minority-and-women-owned small business programs. This increase also includes a request for the Office of Inspector General to assist in their efforts to prevent waste, fraud and abuse.

In non-credit programs, we propose to nominally increase existing "user fees" by $1 million. This includes a $500,000 increase from the sale of business development publications and services of the Procurement Automation Source System (PASS).

Mr. Chairman, the contributions of women to the health and size of our economy have grown considerably in recent years. Between 1977 and 1987, the number of women-owned businesses increased from less than 2 million to almost 4.5 million. These enterprises have prospered. The average receipts for women-owned businesses have increased more than 27 percent since 1980.

The FY 1991 budget submission reflects continuing support for several SBA efforts to build upon these positive trends among women-owned companies.

The budget submission contains $500,000 to continue the work of the National Women's Business Council. As you know, Mr. Chairman, this Council was created by the Women' Business Ownership Act of 1988 to study a variety of issues and to make annual recommendations to the Congress and President on initiatives in procurement, access to credit and other areas. Late last year, I was honored to be appointed by the President to chair the Council. The Council held its first meeting in January, and established four goals. We will focus on data collection, credit and bonding issues, international trade, and procurement.

Two other congressionally authorized programs for women-owned enterprises are also fully operational and are reflected in our

1991 budget. The Women's Business Ownership Act of 1988 created a new demonstration training program for women entrepreneurs, and authorized $10 million for this program over three years - Fiscal Years 1989, 1990 and 1991. Three demonstrations programs funded in 1989 are now fully operational; a fourth will be in operation by April. More than 30 proposals have been received for 1990; we anticipate that this year's grants will be announced this Spring. Congress appropriated $2 million for the program in each of Fiscal Years 1989 and 1990. The FY 1991 submission proposes $5 million.

The Women's Business Ownership Act also created a new small-loan program under SBA's 7(a) loan guaranty program. This program is meant to encourage more lenders to issue guaranteed loans of less than $50,000, providing assistance to an underserved segment of the small business community. Smaller loans are expected to be particularly useful to women business owners, a sector dominated by service enterprises that typically need less capital. Regulations for the small-loan program were issued in September, and loans are now being made.

Overall, the 1991 budget request for $6.4 million for the Office of Women's Business Ownership, including $5 million for demonstration training grants, will allow SBA to meet the needs of the fastest growing sector of the American business community by increasing its outreach to women-owned businesses. The remaining $1.4 million will be used for the management and operations of the Office of Women's Business Ownership.

Mr. Chairman and Members of the Committee, the future of America's business lies with our ability to compete in the international marketplace. The SBA is working with the small business community to promote their prospects overseas. The SBA's Export Revolving Line of Credit (ERLC) is generally a short-term loan of no longer than 18 months and is used to finance materials and labor for dedicated export production. The maximum amount of this loan was increased from $500,000 to $750,000 by the Omnibus Trade Act of 1988. The program provided $10.5 million in capital for small exporters in Fiscal Year 1989, in addition to $26.2 million provided to exporters under the SBA 7(a) general business guaranty loan program.

In 1989, we also implemented a new loan program for exporters, the International Trade Loan program, which was established by the same 1988 Trade Act. The International Trade Loan program provides guarantees for loans up to $1 million and can be used by small businesses for capital expansion for export purposes. Users of an International Trade Loan may also combine it with an ERLC up to $250,000.

Additionally, I have met with the leadership of the Overseas

Private Investment Corporation (OPIC) and the Export-Import Bank to pursue joint efforts to make the government's targeted credit enhancement programs simpler and easier to use for America's small exporters.

SBA also has been active in providing technical assistance to small firms interested in exporting. During FY 1989, SBA sponsored or cosponsored approximately 600 export seminars and workshops across the country, reaching more than 25,000 small business persons. Some of these seminars were major events, such as a two-site conference on the U.S.-Canada Free Trade Agreement, which attracted more than 2,000 participants last June. Others were local seminars, attended by small business persons throughout the country.

In addition, we have forged an excellent working relationship and atmosphere of cooperation with the Department of Commerce. We have assisted in the Department's recent Matchmaker Trade Missions to Canada, Europe and Asia.

As we all know, some areas of rural America have not shared in the prosperity of our nation's record economic expansion in recent years. I believe that entrepreneurship and small business development are keys to helping revitalize our rural communities, and I believe the Small Business Administration has a critical role to play.

In support of the Rural initiative announced by the White House on January 22, I announced on January 24 a 13-point initiative for SBA to focus more effectively on rural economic development. A study published by our Agency last June found that our major financial programs - 7(a) general business guaranty loan program, Development Company Loans and Surety Bond Guarantees - are reaching rural America in rough proportion to the number of people living there. About 23.5 percent of the U.S. population lived in rural counties in 1986; about the same percentage of our major financial programs goes to those areas.

But that's a nationwide average. We believe that some rural communities may not take advantage of our 7(a) loan guaranty program, the Certified Development Company program, Small Business Lending Companies, Local Development Companies or Small Business Investment Companies. Under the new rural initiative, SBA will identify under-served areas and take steps to target the programs more successfully to those areas.

Mr. Chairman, I am pleased to report to you today that the Small Business Innovation Research program has, since its inception in 1982, awarded in excess of 15 thousand funding agreements to direct a share of Federal research and development funds to small high-tech companies - the type of companies which are responsible for most of the nation's new products, processes and technologies. The eleven participating agencies continue to report high quality proposals and performance in this program. Significant innovative awards continue to be made in the areas of information processing, microelectronics, lasers, advanced materials, instrumentation, biotechnology and medical technologies. The growth prospects for commercialization appear very encouraging.

I have recently submitted to the Congress a notification of my intention to move the Office of Innovation, Research and Technology from my office to that of the Associate Deputy Administrator for Special Programs. I believe that this will enhance the development of the full range of the commercialization responsibilities of the program and allow SBIR to be treated on an equal footing with the Agency's other key programs. Current SBA studies clearly indicate the remarkable commercialization potential of the technologies being developed under SBIR. It presently appears that over 20% of SBIR projects are going to the commercial marketplace. The SBIR program is currently authorized through fiscal year 1993.

Mr. Chairman, in FY 1991 our Office of Veterans Affairs will continue its outreach program to America's veterans. Between FY 1988 and FY 1989, our outreach efforts provided a 40-percent increase in the number of veterans receiving counseling by SBA and its resource partners. Within SBA's 7(a) loan portfolio, a full 20 percent of the funds benefit our Nation's veterans.

We anticipate that by FY 1991 all 50 states will be participating in the Agency's Small Business Development Center (SBDC) program. This program has received tremendous support at the state and local levels. Estimates by the Association of SBDCs are that for every dollar of federal funds now put into the SBDC program, at least $1.50 is put in by state, local and private entities. So for this current fiscal year there will be $50 million dollars of federal funds and $75 million of state, local and private funds in the SBDC program.

We expect that this leveraging of federal dollars will increase in amount and proportion in the future. In fact, because of this success, we propose that the SBDC program be independent from federal funding by the end of fiscal year 1992. To accomplish this objective, we are asking for $30 million in federal funds for fiscal year 1991 and $15 million for fiscal year 1992. During this phase-out of federal funding, we will work closely with the SBDCs to help them obtain funds from other sources and to show them how to be effective without federal aid.

And finally, the FY 1991 budget includes requests for several management initiatives. A one-time request of $4.2 million is for the relocation and consolidation of our Washington central offices. These offices are currently housed in six different locations. The move will take approximately six months, and during that time we will be required to pay dual rent to GSA and must also cover other associated relocation expenses.

Our budget also includes a request of $3.5 million to replace our outdated mainframe computer. Both of these initiatives are well underway and on target with scheduled completion dates.

Mr. Chairman and members of the Committee, we are ever mindful of the President's pledge to maintain a strong and healthy economy conducive to the prosperity of small businesses; that commitment to small business was reiterated in the President's State of the Union address in noting that we "encourage risk takers--especially those in our small businesses--to take those steps that translate into economic reward, jobs, and a better life for all of us." We, at the SBA believe the President's budget to be a "good news" budget and a reflection of this Nation's commitment to the small business men and women who contribute so much to our economy and to the opportunities inherent to this great land.

Thank you.

I will be glad to address your questions.

SMALL BUSINESS ADMINISTRATION
FY 1981 CONGRESSIONAL SUBMISSION
BUDGET AUTHORITY AND OUTLAYS
(IN THOUSANDS)

| | FY 1979 Actual | FY 1980 Approp. | FY 1981 Request | FY 1982 Request | FY 1983 Request | FY 1984 Request |
|---|---|---|---|---|---|---|
| Budget Authority: | | | | | | |
| Salaries and Expenses | $236,490 | $344,538 | $326,437 | $315,754 | $309,825 | $318,817 |
| Inspector General | 1/ | 7,400 | 9,864 | 10,174 | 10,415 | 10,699 |
| Business Loans (inc. 7(i)) | 160,590 | 159,500 | 3,000 | 133,000 | 168,000 | 195,000 |
| Disaster Loans | - | 392,840 | - | - | - | - |
| Surety Bonds | 9,497 | 11,000 | 10,200 | 12,500 | 15,200 | 17,700 |
| Pollution Control | 13,656 | 13,000 | 0 | 0 | 0 | 0 |
| Agencywide | $420,233 | $928,278 | $349,501 | $471,428 | $503,440 | $542,216 |
| Outlays: | | | | | | |
| Salaries and Expenses | $312,713 | $341,857 | $329,609 | $316,822 | $310,418 | $317,954 |
| Inspector General | 1/ | 7,030 | 9,227 | 10,158 | 10,403 | 10,846 |
| Business Loans | 68,595 | 25,000 | (38,000) | 2,000 | 50,000 | 87,000 |
| Disaster Loans | (307,220) | 658,000 | (30,000) | (229,000) | (179,000) | (152,000) |
| Surety Bonds | 1,506 | 9,900 | 9,500 | 12,300 | 15,500 | 17,400 |
| Pollution Control | 8,710 | 14,000 | 0 | 0 | 0 | 0 |
| Agencywide | $84,304 | $1,055,787 | $280,336 | $112,280 | $207,321 | $281,200 |

1/ Included in the amount for salaries and expenses

SMALL BUSINESS ADMINISTRATION
FY 1981 CONGRESSIONAL SUBMISSION
PROGRAM LEVELS
($ IN MILLIONS)

| | FY 1979 ACTUAL | FY 1980 APPROP. | FY 1981 REQUEST |
|---|---|---|---|
| General Business | $2,617.9 | $3,161.6 | $3,200.0 |
| Direct | - | - | - |
| Guaranteed | 2,617.9 | 3,161.6 | 3,200.0 |
| Handicapped | 13.2 | 12.0 | - |
| Direct | 12.0 | 12.0 | - |
| Guaranteed | 1.2 | 1/ | 1/ |
| Econ. Opportunity | 50.0 | 17.0 | - |
| Direct | 16.0 | 17.0 | - |
| Guaranteed | 34.0 | 1/ | 1/ |
| Energy | - | - | - |
| Guaranteed | - | 1/ | 1/ |
| Veterans | 17.0 | 17.0 | - |
| Direct | 17.0 | 17.0 | - |
| Development Co. | 364.2 | 472.2 | 450.0 |
| Guaranteed | 364.2 | 472.2 | 450.0 |
| Investment Co. | 50.2 | 248.0 | 100.0 |
| Guaranteed | 50.2 | 248.0 | 100.0 |
| Minority Inv. Co. | 36.0 | 80.4 | 80.0 |
| Direct | 36.0 | 31.0 | - |
| Guaranteed | - | 49.4 | 80.0 |
| 8(a) Loans | 1.8 | 5.0 | 5.0 |
| Direct | 1.8 | 5.0 | 5.0 |
| Guaranteed | - | - | - |
| Total Business | $3,150.3 | $4,011.0 | $3,835.0 |
| Direct | 82.8 | 82.0 | 5.0 |
| Guaranteed | 3,067.5 | 3,929.0 | 3,830.0 |
| Disaster Loans: | 146.7 | 1,813.5 | 285.0 2/ |
| Surety Bond Gtys: | 1,151.6 | 1,250.0 | 1,500.0 |
| Total Agency Credit | $4,448.6 | $7,074.5 | $5,620.0 |
| Direct | 229.5 | 1,895.5 | 290.0 |
| Guaranteed | 4,219.1 | 5,179.0 | 5,330.0 |

1/ These programs were consolidated into the General Business guaranty program.

2/ This program would be restricted to borrowers who "cannot obtain credit elsewhere" and based on the Treasury cost of money.

The **Chairman**. Ms. Engeleiter, let me first of all congratulate you on your statement. I have been on this Committee for a long time and that is by far the best, most comprehensive and helpful statement we have ever had at an authorization hearing.

Ms. **Engeleiter**. Thank you.

The **Chairman**. While we have some fairly dramatic differences about the money, and so on, it is still very helpful for us to know the number of loans and the different programs, what the default rate is and that all goes right to the heart to the oversight this Committee has the responsibility for. And those statistics are all very helpful to us.

So I want to thank you for your candor and for taking the time to prepare what I consider to be a really fine statement.

Now that we have that little formality out of the way, let me ask you, if SBDCs are doing such a great job and returning $1.50 for every $1, why are you cutting them $20 million?

Ms. **Engeleiter**. Well, I would point out, Mr. Chairman, that there is a significant difference between this particular budget and the budget that the President offered last year, which had no funding for the SBDCs. So if you want to look at it in a more favorable light, it is a $30 million increase in the President's request this year——

The **Chairman**. But this Committee chose to put $50 million into the program, and this year you are asking for $30 million for 1991 and $15 million, and you know, you do not have to be a rocket scientist to see where we are headed with what you consider to be a very fine program.

Ms. **Engeleiter**. No, I certainly appreciate that and we at the Small Business Administration feel that it is our responsibility to do whatever we can to assist you in solving the deficit problem that you are facing. Since this is a program that has been very well received by the State and local governments and by private entities and they are matching the money very significantly, putting in 1½ times as much, we really think that that trend will continue and this whole program can be funded without help from the Federal Government by fiscal year 1993.

We certainly would look forward to assisting them from our end in that transition program.

The **Chairman**. Let ask you also about the bill which Chairman LaFalce, who really was the author of this—I shepherded it through on the Senate side. For women, you are asking for a pretty good increase for the Women's Business Training Grant Program, and I heartily support that.

I notice in your statement you say that in 1977 we had 2 million women-owned businesses in this country and 10 years, a little over 10 years later, we have 4.5 million women. And that is a really dramatic increase and it shows the contributions women are making in this country, one of the reasons of course that Chairman LaFalce and I went to bat for this program.

And I see that you are asking for a $3 million increase, but as I said a moment ago, you are cutting SBDCs by $20 million and totaling eliminating what is a really small program of direct loans for handicapped and Vietnam veterans.

Those programs have been around a long time. This is only the second year for the women's program. Does that make sense?

Ms. **Engeleiter**. Well, Mr. Chairman——

The **Chairman**. Let me just ask you a simple question. Why are you proposing to cut those programs totally out?

Ms. **Engeleiter**. Well, the proposal is consistent with the approach that the Administration is taking throughout Government, and SBA is not being treated any differently than any other Agency.

I said in my comments that the direct loan programs tend to have higher losses. In terms of the number of small businesses that can be assisted; the number is significantly smaller with direct loans versus guaranteed loans.

If you look at our 7(a) portfolio, Mr. Chairman, you will find that of the $3.2 billion that is authorized, roughly 20 percent of all 7(a) loans have been going to either veterans or Vietnam-era veterans, and certainly we can always be doing more, but I think that that is a fairly impressive statistic.

I think we can help more Vietnam veterans and veterans in general who are in need of some sort of financial assistance through leveraging money in the 7(a) guaranteed program than we can in the Direct Loan Program, and we can do it with much lower losses.

The **Chairman**. Please bear in mind, of course, one of the reasons for those direct loan programs is because not only is the 7(a) Program sort of a lender of last resort, those small programs really are a lender of last resort and for those handicapped and Vietnam veterans who cannot get a loan under the 7(a) Program.

I mean, there are just a few people out there who need help and cannot get it under 7(a). I mean, it is commendable that 20 percent of the 7(a) loans are going to veterans, for example.

But as I say, if we just worry about the masses here and we do not worry about the individuals who have a tendency to fall through the cracks, we sort of lose our compass and our values as a Nation, do we not?

Ms. **Engeleiter**. Well, Mr. Chairman, our budget does include a continuation of our Veterans Office at the Small Business Administration, and that office has done a remarkable job with relatively small resources. This office performs outreach to veterans' groups around the country; to make them aware of all of our programs and to see to it that participation in all of them is very good. So I really commend the people who are doing the work. As an Agency we have been very effective. And if I might, Mr. Chairman, in regard to your question in terms of the increase in the Women's Grant Program, as I mentioned before, $10 million was authorized over a 3-year period. To date, $4 million of that has actually been spent and if you look at——

The **Chairman**. Now, I am for that, Susan. I——

Ms. **Engeleiter**. Yes, I realize you are, I just wanted to point out to you that the numbers are extremely impressive in terms of the number of women-owned businesses that are being created in the country, 1½ times the rate that businesses are being started by men right now.

The **Chairman**. Is that true?

Ms. **Engeleiter**. Yes, that is according to the——

The CHAIRMAN. What is that again?

Ms. ENGELEITER. Women in the country right now are starting businesses throughout the United States at 1½ times the rate that men are and their failure rates are lower than the businesses that are being created by men.

Now, having said that, and this is a very positive factor in that we have a healthy sector of the economy going here: Women are starting businesses throughout the country at 1½ times the rate that men are.

We still have two problem areas that were addressed in H.R. 5050 and that we are looking at in the Women's Council. One is in the area of credit, and I think we have already gone a long way and the Congress has gone a long way, in passing H.R. 5050 to address that issue. We have implemented and have put into place the Small Loan Program that gives incentives to banks to make loans of $50,000 or less.

There is not a lot of financial inducement for commercial lending institutions to do that, and with this new program there will be increased incentives.

This program is not targeted for women business owners, but since the majority of women-owned businesses are in the service sector and are small, this kind of loan will be going disproportionately to women.

The second major area where there continues to be real obstacles for women-owned businesses is in the area of procurement. One of the goals of the Women's Council is to obtain more complete data on women-owned businesses. According to the data that we currently have on women-owned businesses, and it is not terribly complete, women own roughly a third of all the businesses in the country, yet procure less than 1 percent of all Federal contracts. So there certainly is room for improvement in that area. The Demonstration Grant Program has been a very positive improvement, although it is a young one. We think that some of these procurement obstacles can be tackled through additional funding of the program.

The CHAIRMAN. I am not going to question you on the increase in user fees that you are proposing. There are literally dozens of those throughout the budget, not just in small business, but all across the Government.

Now some of those may float. I am not one who is just adamantly opposed to user fees, but when you, for example, have somebody who comes into SBA requesting a $500,000 loan under the 7(a) Program and you tell him for openers that there is a 5 percent fee or $25,000, so you are not really going to loan him $500,000, you are going to loan him $525,000 and he does not have to cough it up on the front end, but that has a pretty chilling effect, does it not, on somebody who is fiscally responsible and trying to do the right thing, to tell him you are going to hit him with a $25,000 fee on the front end before you start charging him interest?

Ms. ENGELEITER. Well, as I mentioned before, Mr. Chairman. Based on the average 7(a) loan size that the Agency has been doing, the increase amounts to about $75 a month over the life of the loan. It sounds a little better in those terms.

The CHAIRMAN. I was going to say I know where we are headed now. We are getting nibbled to death by a duck, but go ahead. [Laughter.]

Ms. ENGELEITER. Well, my response is that when you put it on monthly terms it is a little more digestible.

The CHAIRMAN. Well, as I said, I am not going to belabor that because we "ain't" going to do that. [Laughter.]

And the 8(a) Program, as I understand it from your testimony, you have the new application forms ready, printed in bulk and they have gone out to all of your offices?

Ms. ENGELEITER. Yes, Mr. Chairman, as of today, those forms were available in all——

The CHAIRMAN. As of today?

Ms. ENGELEITER. Well——

The CHAIRMAN. You really covered yourself, because I was getting ready to tell you—[Laughter.]

As recent as a week ago, we were still getting complaints from across the country about not being able to apply for an 8(a)——

Ms. ENGELEITER. There were, Mr. Chairman, some problems in terms of getting those forms printed through the Government Printing Office and out to all the district offices, but all offices now have them.

And I would like to point out, if I might, in regard to 8(a), when I started on the job and was formally sworn in on May 1 of last year, the regulations for that program had already been promulgated and there were 300 fairly significant comments received regarding those final regulations. A lot of my personal time, as well as the time of many of our senior staff during the first 4 months of my tenure at SBA was spent rewriting those regulations.

I think that we, thanks to the legislation that you passed, have significantly improved the program. In small part thanks to the regulations, we have a program that is far less subjective and I think provides much more of an opportunity for equal access to the program.

So while we are very anxious to get it going, it is a complex law and looking at just how complex it is and what is required, I think that actually the Agency has done pretty well in getting it up and running as quickly as it has.

The CHAIRMAN. Ms. Engeleiter, let me shift to the SBIC Program. I think they probably take the biggest hit of anybody in your proposal, about $250 million to $100 million, is that correct?

Ms. ENGELEITER. Yes.

The CHAIRMAN. What do you have against them? [Laughter.]

Ms. ENGELEITER. Well, Mr. Chairman, I do not have anything against them, and in fact, if I might, I would like to make a few general comments about the Small Business Investment Company Program.

The CHAIRMAN. I am concerned about that program. I am concerned about some of the things the Inspector General will probably testify to this afternoon, but generally I think we have about 400 SBICs in the country, and for the most part, their defaults have not been that dramatic. And I think they have been performing at a pretty good—shall I say, function for the Government.

But when you cut that much, that sounds like a lot and I am just asking. You may have a perfectly good justification for it, let me hear it.

Ms. ENGELEITER. Well, I think we do, Mr. Chairman. For the SBIC Program request we are suggesting that our program level be reduced from $246 million to $100 million. If you look at the amount of activity in the program last fiscal year, only $50 million was used. If you recall, some of the fiscal year 1989 funds before I came on board were reprogrammed into the 7(a) Program. So the activity level suggests that there will not be a justification for appropriating $246 million since the usage level was only $50 million last year.

And if I might make a few comments, broader in scope, in regard to the program; I do not think there is any question that we are going to see an increased need in venture capital, generally, for small firms.

In fact, one of the studies that our Office of Advocacy will be doing with its research budget this next year will be to look at the need for equity financing by small firms. We have had, unfortunately, a few problems of some magnitude in the SBIC Program.

The Inspector General will be talking about several of his reports in regard to the program. As a result of one of his audit reports that came to me last year, I was very concerned about the liquidation process. Immediately after reading the EWE audit report, I commissioned an independent study to look at the SBIC Program; to see how we might improve it and keep it a healthy program, because I think it is a very good program, as you do.

I have received a first draft of phase 1 of that study, which looks at the liquidation process within the SBIC Program. Very shortly I will be receiving phase 2 of that report from the Irving Burton consulting firm. That phase looked at the front end of the program; how we regulate the program, whether we are over-regulating or under-regulating in terms of determining who ought to be in the program.

I think once that study is complete, we may be able to make some changes in the program and in fact, Mr. Chairman, we have already made some very significant changes in regard to the liquidation process to improve the quality of the program, as a direct result of the preliminary study that we received.

It is my understanding that cumulative losses through last year were roughly 11 percent in the program, and we would like to keep them certainly as low as possible.

The CHAIRMAN. Well, that is a fairly good answer, and I want to say, you and I discussed on the phone the other day some broader oversight questions which you said you did not feel sufficiently prepared to answer at this hearing, and I told you we would have an oversight hearing later.

I would like to do that, of course, within the next 2 or 3 weeks if it can be arranged, but as I said, the IG is going to testify this afternoon about some things that did not happen on your watch, so you do not have to be defensive about it——

Ms. ENGELEITER. Right.

The CHAIRMAN [continuing]. But some things that are really fairly alarming to me and I am sure will be to the other Members of this Committee once it is all fleshed out. I do not want to get into that this afternoon, but I do want to make sure that everybody is prepared to discuss this at the next oversight hearing on the SBICs.

And having said that, let me ask you a couple of questions along those lines, and I do not want to pursue that, but at what point, when a local office—say, Little Rock—has to take over the collateral of a loan, at what point do you, if you ever do, get involved in the decision of whether to keep it, sell it, develop it or make some other disposition of it?

Ms. **Engeleiter**. If you do not mind, I am going to ask Mr. Rosenbaum to respond to that.

The **Chairman**. Not at all, go ahead.

Mr. **Rosenbaum**. Mr. Chairman, generally the collateral that we acquire in our district offices is managed by that district office.

With respect to the SBIC Program collateral, we centrally manage the program, but for efficiency purposes the collateral which is located, let us say in Arkansas, would be managed by the Arkansas district office. However, the decisionmaking for the disposition of that collateral would be made at the central office.

The program directors and senior manager's in the Agency, usually within the finance and investment office, would make the decision whether we should sell the collateral, retain it, or enter into a receivership in some cases.

The **Chairman**. Let me just stop you there. Can that decision be made in Little Rock or does it have to go to Dallas to the regional office——

Mr. **Rosenbaum**. No, in the case of SBIC collateral, the decision is made in Washington because it is a central office managed program.

The **Chairman**. No, I am not talking about SBICs now. I am just talking about 7(a) for example.

Mr. **Rosenbaum**. In the case of 7(a) loan collateral, it would be the decision of the district office, with certain guidelines from the region. Very seldom is the central office involved in that decision at all. The management of the collateral is done at the district level.

The **Chairman**. As you know, Mr. Gillum is going to testify this afternoon about an incident where, I think it was in New Jersey, a piece of property was kept by SBA for 8 or 9 years and the mortgagor was permitted to occupy that property during all of that time and it continued to deteriorate where it became virtually worthless.

If you know, how can something like that happen? Was that just a bad decision on the front end?

Mr. **Rosenbaum**. Well, Mr. Chairman, it appears, and I do not know the specific case, that may very well have been a bad decision.

I have to also reiterate that we manage a significant amount of collateral all over the country, and it is managed at the district level. One of the things we are looking at, and Ms. Engeleiter is trying to instill in the Agency, is better management and more central decisionmaking in this area.

There are isolated cases, I am sure, where things like this could happen, and obviously we would want to avoid them in the future. But for the most part, I think the collateral is managed efficiently and we have had good success in turning over our collateral and selling it once we acquire it.

But in these isolated instances, Mr. Chairman, where these things do happen, we are trying to focus on them, in order to reduce the number of these incidents as best as possible.

Ms. ENGELEITER. Mr. Chairman, if I might add, the study that I referenced is ongoing right now. It was precipitated in the SBIC Program by the audit that suggested that there were perhaps some irregularities or potential problems in the whole liquidation process of the SBIC Program. That audit was alarming and the preliminary results we have are alarming. Because of this, we have commissioned a third phase of this study to look at the liquidation process for all of the 7(a) Programs.

We do not have any evidence to suggest that there are any significant problems, but in light of what we determined with the SBIC preliminary report, we have added the 7(a) Program to our study.

The CHAIRMAN. We also have a GAO study going, as you perhaps know, on the same thing, on how well we are doing with liquidation of assets, and so on. I am not sure—John, when will that be ready, do you have any idea? Well, he tells me that will not be ready until next year.

But let me just close, we have a lot of other Senators to ask questions here and I have other questions, but I want to give them an opportunity by asking you this question.

When it comes time, if somebody is in default, and the local managers decide, for example, that it is probably better to cut a deal with him and take a loss than it is to liquidate the property, is the procedure very much the same as it was for the other matter of liquidating the assets? Who has the right to say, OK, we are holding a second mortgage anyway, and we are going to take a hit of $100,000 here and it is probably going to cost $120,000 if we liquidate it. So we will just go ahead and take the hit on the front end. Who makes those decisions?

Mr. ROSENBAUM. Mr. Chairman, there are three member Claims Review Committees in each region and in the main office. Depending on the size of the unpaid loan balance, the decision is made at one of these three levels as to whether there will be acceptance of a compromise on the loan liquidation.

At that time, they could, as you say, strike a deal and walk away, take their losses and at the same time have the borrower pay off what he can and clean the slate.

We have done that and it is a normal business practice, not only at SBA but also in the private financial marketplace.

The CHAIRMAN. I think the more definitive you can make your regulations, I am not suggesting—you know, sometimes common sense is better than a regulation, and as long as you use fairly good judgment we are not going to raise a lot of hell in this Committee about it.

And you have taken a lot of pressure off the people sitting on this side of the table because we always get calls from constituents saying, please call SBA and make them take the deal I have offered them.

I used to call them and tell them to take the deal, until I got to be Chairman of this Committee and I found out, they will do anything when you are Chairman of this Committee. I am very circumspect about that sort of thing.

But in a more serious vein, it is better if you have fairly definitive guidelines for these people, where they can say to me or Senator Lieberman or Senator Lott or somebody else, we just cannot do that, you know.

And I appreciate them when they do that, and sometimes I may feel that there is another way better, but they say, look, our rules are very specific on this, and we would have to get Ms. Engeleiter involved before we could do anything differently.

And that is sort of helpful to us, even though sometimes we may not feel that it is always the best deal.

Ms. ENGELEITER. Mr. Chairman, if we could provide for you in great specificity exactly what the process is for the record, if that would be all right?

The CHAIRMAN. You certainly may.

[Material follows:]

# INFORMATION PROVIDED FOR THE RECORD
# SENATE SMALL BUSINESS COMMITTEE

Chairman Bumpers

Question: Please provide for the record exactly what liquidation process procedures are in your district offices.

Answer: When it becomes apparent that a given borrower cannot or will not repay the SBA loan, the account is placed "in liquidation". While the procedures followed from that point vary on a case-by-case basis, as may be dictated by state law and circumstances unique to the case, the overall objective is to produce the maximum recovery to the Government in the shortest period of time.

The usual liquidation procedure is to sell the business assets in the manner prescribed by local law or custom and then proceed against the individual guarantors for the remaining balance. The compromise process generally comes into play at this point. If a guarantor offers an amount which approximates the amount SBA could reasonably expect to recover by all legal remedies at its disposal, a compromise settlement is preferable to litigation. For the most part, actions of this type can be acted on at the district or regional levels.

On less frequent occasions, SBA may accept an offer in compromise from an ongoing business - including farm or ranch operations. Two primary conditions must be met before an action of this type can be approved. First, it must be shown that the amount offered approximates the amount SBA could reasonably expect to recover by using all legal remedies at its disposal. Second, other major creditors of the business must also be willing to write down or compromise as you would expect in a Chapter 11 bankruptcy case. This type of compromise must be recommended by the district and regional offices for final decision here in Washington.

Senator LOTT. Thank you, Mr. Chairman, I will be brief because we have such good attendance here today, and I know everybody would like to get in a couple of questions, so I will focus in on a couple of areas where I am particularly interested and have some concern.

I understand that you are proposing to limit eligibility for disaster loans to those unable to obtain credit elsewhere, and increasing from 4 percent to 8 percent the interest rate to the Treasury's borrowing rate. Is that correct?

Ms. ENGELEITER. Yes, that is correct.

Senator LOTT. I am from a State that has had a lot of disasters and we have really been very much dependent on SBA's Disaster Loan Programs. It has been very helpful.

I understand how you do not want to make loans to people that can get those loans elsewhere, but I really have trouble understanding why you would also propose increasing that interest rate from 4 percent to 8 percent for those people who cannot afford to borrow money from regular, conventional lending institutions.

I mean, one of the problems is that when you have been wiped out, you often already have one loan. If you have to get a disaster loan it is an additional burden. The only way it is possible for them to pay those loans and to make ends meet is to have a lower interest rate.

So why would you be proposing to raise the rate to prime?

Ms. ENGELEITER. Well, Senator, I am glad you agree that people who can get the money somewhere else, should use other lending sources other than SBA.

Senator LOTT. I think that is a bureaucratic problem, I might add. I mean, that has been on the books in the past, as I recall, after disasters, that somebody who is really wealthy can get a loan from the bank, but then you get a question sometime as to how many does it take? Do two or three have to turn them down?

But there is no need to get into that. The question is why do you want to raise that lower interest rate?

Ms. ENGELEITER. The raise is consistent with the Administration's move to adjust the interest rates for all programs to the cost of money. The purpose of the program remains; that if people have been turned down elsewhere they can still take advantage of our loans if they can show that they have the ability to repay the loan.

It is very similar to what the 7(a) Program does. Those loans are made at the cost of money, but there is still an advantage to the small business in that our loan terms are structured in such a way that people can get the kind of loan that they want, and can afford to pay back.

Senator LOTT. But remember again, these are people who have quite often lost everything they had, and they already had a loan, usually, pending. I would just make the point here, I would be very much opposed to that particular proposal.

I think that there is a reason for giving them a low interest rate, and I do not think the Government should be involved in a lot of areas, but when you are flat on your back, you have been hit by a tornado in Arkansas or a hurricane in Mississippi or an earthquake in California, then I think we need to give them special consideration.

Ms. ENGELEITER. Senator, I totally agree with you, but there already exists a program that basically does what you are indicating is needed. That program is the Family Grant Program that is administered by the Federal Emergency Management Administration.

Senator LOTT. I understand, but that is for the very low income.

Ms. ENGELEITER. Right.

Senator LOTT. I am also worried about that blue collar person, the shipyard worker and plant mill worker——

Ms. ENGELEITER. They do not qualify for that one?

Senator LOTT. That is right, they are in that twilight zone between the very poor and the wealthy and I do not want us to neglect their tremendous needs out there.

Ms. ENGELEITER. If someone cannot qualify for our program once the interest rate is adjusted up to 8 percent, they will fall into the FEMA Program.

So the people that you are concerned about will be covered under that Family Grant Program at FEMA. For instance, in Puerto Rico after Hugo, one-quarter of all of the families affected did qualify for SBA assistance therefore the other three-quarters of the families affected were referred to the Family Grant Program for assistance.

Senator LOTT. Well, I have made my point, I am very much opposed to raising that and I am sure we will have a chance to discuss it.

The CHAIRMAN. You sound like a Democrat, Senator Lott. [Laughter.]

Senator LOTT. Well, we are from the same neck of the woods. Sometimes we agree on things like this. [Laughter.]

The next one, and that is the 8(a) program. You and I have talked about this before. I am very much concerned about it.

I think it has been a program that has been neglected. I think it has been replete with bureaucracy. You know, in our State of Mississippi, we had six, six—total—approved in 1989. To your credit, so far this year, we have already had six. So I thank you——

Ms. ENGELEITER. I was going to point that out.

Senator LOTT. Yes. Well, I have been raising enough cain, it ought to begin to make a little——

Ms. ENGELEITER. I checked before I came, Senator.

Senator LOTT. Right, six so far this year, so you are doing much better.

Ms. ENGELEITER. It is only March.

Senator LOTT. But that is my point. I do think it is an important program. We need it. We need it particularly in a state like the ones we represent here, particularly the Chairman and I.

I would be interested in knowing some of the things you are doing to respond to the legislation that was passed in this area and trying to improve the bureaucracy and the time and the approval rate.

Ms. ENGELEITER. Well, there was a lot that was built into the law, Senator, to improve the approval rate. There was a provision that required a 90-day turn around that was put into the law.

We are pretty well along in implementing the law. On January 16, we began operation of our 10 divisions of certification around the country, which should help speedup the process.

We have held 20 sessions since May of last year providing training to more than 500 Agency personnel who will be helping with this new process to get service to more minority small businesses.

And as I mentioned before, we have distributed revised forms for the program throughout the country.

We have also put into place the statutory mandate that manufacturing contracts in excess of $5 million and contracts in excess of $3 million in all other industries have to be awarded to 8(a)-eligible firms by competition, rather than by sole source. To date, the Agency has accepted procurement opportunities worth over $200 million for that new 8(a) competition program, which I think is extremely positive.

Another initiative that I have undertaken is in light of some of the unique problems that our native American population faces in this country, particularly those native Americans living on tribal lands. We have been working with the Select Committee on Indian Affairs in the Senate to see to it that not just 8(a) but all of our programs are made more accessible to native Americans. We have recently hired a specialist, a lawyer who teaches tribal law, who is working in our Office of General Counsel and is doing nothing else but looking at how we can make 8(a), as well as our other programs more available to native Americans.

So I think we are taking some steps forward and should there be oversight hearings on this program in the future, one of the issues that I think ought to be looked at is the geographic distribution of the program.

As you know, right now, a person's participation in the program is based on how much buying the Government is doing in the area of the country where they live.

And consequently, if you look nationwide at the participation rate in 8(a) because of the way the program runs—and it is not up to SBA, it is the way that agencies purchase their goods and services—there is not a geographic distribution that matches where there are minority populations in the country.

That is one of the underlying premises of the whole program, but it is one that does not necessarily give the percentage of contracts in relationship to the size of the minority community——

Senator LOTT. Well, I certainly agree with that.

Ms. ENGELEITER. But that is something I think would need change in the legislation——

Senator LOTT. You are making a little progress. I hope you will keep working on it.

One final comment, Mr. Chairman, before I yield my time. I found after one of the disasters in our State that the Atlanta office—you have an outstanding person in charge there, June Nichols is doing a great job—but, as Regional Administrator, there she is in Atlanta and the disaster office is in Birmingham, AL.

And when they were doing dumb things, it was hard to put your finger on who was in charge to get them to do what needed to be done. And what jurisdiction or authority does the Regional Administrator have over a disaster office or if you have a problem in a disaster office like the one in Birmingham or Atlanta, do we have to come to Washington to get the problem resolved?

That does not seem very practical to me. Somebody has to be in charge.

Ms. **Engeleiter**. Senator, I think that is a very valid concern that you raise. The Regional Administrator does not have any oversight over those employees in terms of disasters.

The Disaster Program needs to be flexible since we often need to relocate employees from one part of the country to another. For instance, in light of Hurricane Hugo, the Agency went from 325 disaster staff to 1,550. We have processed about 67,000 loans as a result of Hurricane Hugo and the disaster in California, the earthquake.

So we need to be flexible in terms of relocating people. This past year we had to find people throughout the Agency, not just in disaster, but in other areas who could speak Spanish in order to be able to send them to Puerto Rico and the Virgin Islands in order to meet the demand.

In response to your general observation that the chain of command does not seem to make a lot of sense. To be quite frank with you, there are other instances throughout the Agency where to me that seems to be the case and consequently we have commissioned what is called Total Quality Management. This is a program throughout the Government where the Office of Personnel Management is very much encouraging Federal agencies to do an overall study of the delivery of services and how the Agency is organized in terms of structure.

We are just about through with our study and I think it will be extremely helpful in streamlining the Agency and having more accountability in the long-term.

Senator **Lott**. Thank you, Mr. Chairman.

The **Chairman**. Senator Lott, thank you, and if you would like, we will, in this oversight hearing we will include disaster loans and put them in that oversight hearing.

Senator **Lott**. I think it is something we need to continue to look at because we learn from every disaster, and we can improve how we deliver after each disaster. And I think those who were afflicted this year would like to have that opportunity.

The **Chairman**. Susan, let me also say that based on everything I know now, you all did a superlative job both in Hurricane Hugo and the San Francisco earthquake.

Senator Lieberman?

Ms. **Engeleiter**. Thank you, Mr. Chairman. I really appreciate that.

Senator **Bumpers**. Senator Lieberman.

Senator **Lieberman**. Thank you, Mr. Chairman. Mr.Chairman, I have an opening statement which I would ask be printed in the record as if read.

The **Chairman**. Yes, and there are other opening statements by Senator Bond, Senator Pressler and Senator Grassley.

Senator **Pressler**. If you would put mine in the record also, I would appreciate it.

The **Chairman**. Also, Senator Pressler.

[The prepared statements of Senators Boschwitz, Lieberman, Pressler, Grassley, Bond, Dixon, and Wallop follow:]

## STATEMENT OF SENATOR RUDY BOSCHWITZ
## HEARING ON SBA REAUTHORIZATION
## MARCH 8, 1990

Thank you very much, Mr. Chairman. It's a pleasure to begin with you the process of reviewing the operations of the Small Business Administration in connection with our anticipated reauthorization of the agency for fiscal year 1991.

I'm also delighted to see my friend, the Administrator, Susan Engeleiter.

Mr. Chairman, let me just say that I am very optimistic about the direction the SBA is heading. We now have received the Bush Administration's first budget for SBA and its pretty good. There are some points in which I disagree with the President, but for the most part his budget reflects his support for the agency and its administrator.

In addition, whereas other agencies have been subject to negative press coverage of late regarding their financing programs, the SBA hasn't been the subject of such criticism. In fact, a recent review of the SBA turned up no problems which are not correctable, outside of the losses being experienced in the Small Business Investment Company program. That is due in part to the careful oversight of this Committee under your leadership, Mr.

Chairman, but also due to the care with which the SBA approaches the task of lending the taxpayers' money to private individuals.

I am very pleased that the Administration has proposed to maintain the FY90 funding for 7(a) lending in its FY91 proposal; I'd be supportive of an increase over the FY90 appropriated levels, but I don't think the budget realities permit it, without some changes in the SBA's other lending programs. If we want to see future growth in this program, it may be necessary for some program consolidation.

I am also very pleased that the Administration now recognizes the value of the SBDC program. I say that, because as you know, Mr. Chairman, in years past, the previous administration has proposed abolishing the program in its entirety. So we've made some progress. And as you know, Mr. Chairman, the General Accounting Office recently gave the SBDC program a strong endorsement in an audit which you requested. The SBDCs are a valuable resource for small business owners and managers to turn to for assistance in solving management problems.

Overall, the Administration's budget proposal is pretty good. I look forward to hearing the testimony of the Administrator and of Mr. Gillum.

## STATEMENT OF
## SENATOR JOSEPH I. LIEBERMAN

## SENATE COMMITTEE ON SMALL BUSINESS

## HEARING ON THE SMALL BUSINESS ADMINISTRATION'S FISCAL YEAR 1991 BUDGET

March 8, 1990

Mr. Chairman, in recent years it has become increasingly apparent that the role which small businesses play in the U.S. economy is becoming more and more invaluable to our overall economic health. Many economists, in fact, now believe that small businesses play the crucial role in the U.S. economy, and some even credit small firms for the sustained economic growth and job creation that occurred throughout the 1980's.

As such, I find it ironic that in the early 80's President Reagan suggested the outright elimination of the U.S. Small Business Administration. Yet, at the end of his tenure, President Reagan stated that "A wider appreciation of the innovation, competitive strength, and the quality of life that small firms bring to our economy is an important goal for all who are interested in the long-term economic health of our nation".

The United States continues to be the world's greatest economy, but the 1990's present us with a new set of challenges. We are now faced with a ballooning budget deficit, an unprecedented trade deficit, and record low savings and investment rates.

It is clear that we are losing ground to the Japanese and the West Germans. The Dynamic Asian Economies of South Korea, Taiwan, Singapore, Hong Kong, and now such emerging nations as Thailand also pose a competitive threat to U.S. firms. In addition, as 1992 approaches, it is apparent that the European Community will also become an economic force with which to contend.

Yet, as we leave an era marked by cold war, and enter one marked by global competition, the United States has one clear advantage - the strength, vitality, and ingenuity of America's small business owners.

Given these thoughts, what should be the role of the Federal Government in assisting small business, and how important is this assistance to the future competitiveness and productivity of the United States? What should be the size of the S.B.A. budget?

Mr Chairman, I believe that an investment in Small Business is an investment in our economic future. The proposed budget for the Small Business Administration represents an improvement over budgets of past years, but I'm not convinced that it sets forth the kind of commitment and investment that is really needed for expansion in the small business sector of the economy.

A recent article in the Wall Street Journal entitled "Small Business Borrowers are Feeling Credit Squeeze", suggested that "the explosion of debt that supported the economic expansion of the 80's is over. We are going to see a tighter credit market all down the line." The article went on to say that "tight credit is part of a new conservatism among banks, and small businesses are going to feel it first."

That is why I am concerned about some of the items contained in your FY 1990 budget. Why is there a 3% increase in guaranty fees on Section 7(a) loans, a $20 million reduction for Small Business Development Centers, and the elimination of all direct loans to Handicapped, Vietnam Veterans, Minority Enterprise Small Business Investment Companies, and others.

Mr. Chairman, the budget before us represents a status quo approach to an altogether different set of economic and global circumstances. As such, I look forward to working with you, the committee, and Administrator Engeleiter, to determine what changes we should make in this proposal to better reflect the importance and the needs of small business in the U.S. economy.

STATEMENT OF

UNITED STATES SENATOR LARRY PRESSLER

BEFORE THE

COMMITTEE ON SMALL BUSINESS

MARCH 8, 1990

Mr. Chairman, thank you for scheduling today's hearing that will examine the fiscal year 1991 budget for the Small Business Administration (SBA). This is one of the most important oversight responsibilities of this committee.

I share my colleagues' enthusiasm for Susan Engeleiter's performance as Administrator. Building on the leadership of former SBA Administrator and my former Senate colleague, Jim Abdnor, Susan has helped revitalize the agency.

I look forward to this review of SBA's programs.

# STATEMENT OF SENATOR CHARLES E. GRASSLEY
# SMALL BUSINESS COMMITTEE HEARING ON SBA BUDGET AND REAUTHORIZATION OF AGENCY PROGRAMS
MARCH 8, 1990

Mr. Chairman:

I want to thank you for holding this hearing to review the President's proposed budget for the Small Business Administration and the reauthorization of the Agency's programs.

Small businesses play a vital role in building our nation's economy and the Small Business Administration plays a vital role in assisting our nation's small businesses. President Bush's FY 1991 budget proposal contains a $349.5 million request for the Small Business Administration. I am especially interested in the budget proposal for the Small Business Development Centers as I have had recent inquiry's regarding the effectiveness of the program. I also look forward to learning more about the Women's Business Training Centers as well as the Rural Economic Development programs.

It is our goal to determine if this proposal accurately reflects the foreseen needs of the SBA in the coming year. I look forward to hearing the testimony of the Small Business Administrator and the Inspector General regarding this budget proposal and the reauthorization of agency programs. I want to thank Mrs. Engeleiter and Mr. Gillum for appearing before the Committee today.

STATEMENT
SENATOR CHRISTOPHER S. BOND
SMALL BUSINESS COMMITTEE HEARING
MARCH 8, 1990

MR. CHAIRMAN, IT IS WITH GREAT PLEASURE THAT I JOIN YOU AND THE OTHER MEMBERS IN WELCOMING ADMINISTRATOR ENGELEITER TO OUR COMMITTEE. SHE HAS CERTAINLY DONE A MARVELOUS JOB THUS FAR, AND I LOOK FORWARD TO HER CONTINUING GOOD WORK.

IN PARTICULAR, I KNOW THAT SUSAN, AND HER MANY CONSCIENTIOUS EMPLOYEES, HAVE DONE A TREMENDOUS JOB IN ASSISTING THE DEVASTED COMMUNITIES AFTER THE EARTHQUAKE AND HURRICANES OF LAST YEAR. NO ONE RELISHES THAT PART OF THE JOB, BUT FROM ALL REPORTS I RECEIVED, THE SBA WAS ON THE SPOT WITH ASSISTANCE UNDERWAY IN A VERY TIMELY MANNER.

HOWEVER, YOU HAVE ALSO BEEN ABLE TO HELP OUT IN MUCH HAPPIER CIRCUMSTANCES -- I'M REFERRING HERE OF COURSE TO YOUR FINE WORK IN ASSISTING THE BUDDING DEMOCRACIES IN EASTERN EUROPE. I HOPE YOU WILL LET ME KNOW WHAT I CAN DO TO BE OF HELP IN THIS AREA.

UNFORTUNATELY I HAVE SEVERAL OTHER HEARINGS SCHEDULED, THUS I MUST LEAVE, BUT I HAVE TWO QUESTIONS I HOPE YOU WILL ADDRESS AT SOME POINT THIS AFTERNOON.

FIRST IS THE DECISION TO CUT THE SBDC PROGRAM (SMALL BUSINESS DEVELOPMENT CENTER) BY 40%. THIS PROGRAM HAS WORKED FOR MISSOURI, PARTICULARY IN OUR RURAL COMMUNITIES, AND WHILE I UNDERSTAND YOUR BUDGET CONSTRAINTS, I WOULD HOPE FUNDS COULD BE FOUND.

AND SECONDLY, COULD YOU TELL ME WHAT THE EFFECT OF THE PROPOSED CHANGES IN THE DISASTER LOAN PROGRAM WOULD HAVE HAD ON THE $658 MILLION IN LOANS YOU MADE LAST YEAR?

THANK YOU.

# STATEMENT BY SENATOR ALAN J. DIXON
# BEFORE THE COMMITTE ON SMALL BUSINESS
# ON THE
# SMALL BUSINESS ADMINISTRATION BUDGET/AUTHORIZATION
# MARCH 8, 1990

MR CHAIRMAN, I AM ENCOURAGED BY ACTIONS THAT MRS. ENGELEITER HAS TAKEN TO IMPROVE THE EFFICIENCY AND EFFECTIVENESS OF THE SBA SINCE SHE WAS SWORN IN AS ADMINISTRATOR LAST MAY.

MY COLLEAGUES AND I HAVE HEARD IN RECENT TESTIMONY THAT ECONOMIC TRENDS POINT TO A BLEAK FUTURE FOR AMERICA. WE HAVE BEEN TOLD THAT OUR ONCE ADEQUATE LEVELS OF COMPETITIVENESS AND PRODUCTIVITY HAVE BEEN SURPASSED BY EMERGING INDUSTRIAL NATIONS OF THE PACIFIC RIM AND EUROPE. SUPPORTING THESE ASSERTIONS IS THE LOSS OF OUR UNDISPUTED LEAD IN THE STEEL, AUTOMOTIVE, MACHINE TOOLING, AND CONSUMER ELECTRONICS INDUSTRIES TO FOREIGN COMPETITORS.

THE BUSINESS PRACTICES OF THE PAST HAVE TO CHANGE OR WE WILL CONTINUE THIS NEGATIVE SLIDE. GOVERNMENT AND BUSINESS HAVE TO REVERSE THEIR HISTORICAL ADVERSARIAL ROLES AND BECOME PARTNERS IN BREATHING LIFE BACK INTO AMERICA'S ECONOMY. CHANGES IN OUR TAX LAWS HAVE TO BE MADE TO INCENTIVIZE BUSINESS TO INVEST IN AMERICA. WE MUST CONTINUE TO IMPROVE THE EDUCATION PROCESS TO PROVIDE BUSINESS WITH A QUALIFIED WORKFORCE.

THE SBA HAS TAKEN AN ACTIVE ROLE IN WORKING WITH BUSINESS AND PROVIDING EDUCATIONAL OPPORTUNITIES FOR THE WORKFORCE. MRS. ENGELEITER HAS VOICED HER SUPPORT TOWARDS EFFORTS TO REDUCE THE COST OF CAPITAL TO INCENTIVIZE INVESTMENT AND THE BOOSTING COMPETITIVENESS THROUGH TAX CREDITS FOR RESEARCH AND EXPERIMENTATION. I LOOK FOR THE SBA TO CONTINUE TO LEAD IN THESE AREAS AND SET THE PACE FOR OTHER GOVERNMENT AGENCYS.

HOWEVER, DUE TO THE ECONOMIC POLICIES OF THE PAST DECADE, WE FIND OURSELVES WITH BUDGET LIMITATIONS AND WE CAN NO LONGER BE EVERYTHING FOR EVERYONE. IT IS EXTREMELY IMPORTANT THAT WE APPLY OUR LIMITED FUNDS TO THE RIGHT INITIATIVES -- THOSE THAT WILL PRODUCE RESULTS. I WOULD HOPE THAT THE SBA TAKES INTO ACCOUNT THE IMPORTANCE OF SUPPORTING THOSE ENTERPRISES THAT BUILD THE ECONOMIC WEALTH OF THE NATION THROUGH MANUFACTURING AMERICAN PRODUCTS.

MR. CHAIRMAN, I LOOK FORWARD TO THE THOUGHTS ADMINISTRATOR ENGELEITER AND INSPECTOR GENERAL GILLUM HAVE ON THESE ISSUES.

# STATEMENT BY SENATOR MALCOLM WALLOP ON
# THE SMALL BUSINESS ADMINISTRATION'S FY 91 BUDGET
## THURSDAY, MARCH 8, 1990

Thank you, Mr. Chairman, for holding today's hearing on the proposed fiscal year 1991 budget for the Small Business Administration and the reauthorization of agency programs. I look forward to hearing the testimony of Administrator Engeleiter and Inspector General Charles Gillum. I believe Mrs. Engeleiter has accomplished a great deal in her early tenure and I am anxious to hear about her plans and priorities for the coming fiscal year.

The budget request of $349.5 million for FY 91 which President Bush has sent to Congress in my view demonstrates a great understanding of the vital role which the small businesses of America play in our national economy. There are several aspects of this budget worth highlighting, particularly a 30 percent increase in the loan guarantee authority, a possible increase of 61 staff positions, a proposal to provide new venture capital to minority entrepreneurs and $500,000 for the East European Trade Center planned by the U.S. Chamber of Commerce. This funding will be used for a training program to assist American businessmen and trade delegations in the Pacific Basin, an area which also holds great potential for possible joint ventures with U.S. companies.

In my own state of Wyoming, we recently activated a Foreign Trade Zone at Casper. The zone holds a great deal of economic development potential for the state. The trade zone will allow manufacturers to import goods duty-free for production of export goods. As such, I am continually looking for trade opportunities and the East European Trade Center is certainly a welcome federal/state cooperative if we are to open new markets for U.S. products. Along those lines, I would encourage the Small Business Administration to make every effort to enhance our export assistance activities, whether it be through technology transfer, financial assistance, trade missions or improved outreach activities designed to foster growth and innovation. I think everyone agrees that before we can establish good trade relations with other nations, we must focus on educating and training our businessmen and women here at home about the various aspects of world markets.

In addition to improving trade relations abroad, however, we also have some very real small business concerns to address here at home. Our congressional agenda is chalk-full of legislation which more often than not is anti-small business. In the last session of Congress we spent a great deal of time and energy to defeat the behemoth we all know as Section 89 and we are still attempting to delay the implementation of costly regulations promulgated by the EPA to address the underground storage tank liability problem.

More recently, we have resumed the debate of a truly cumbersome clean air bill which must be modified to address a number of small business concerns. And, looking down the road, we may soon be considering legislation mandating health benefits and parental and medical leave, both of which would be very costly for small businesses.

Time and time again, the annual gripe list of small businesses contains a complaint about too much government regulation and intervention. Small businesses find it overwhelming to comply with costly mandates. With that in mind I would hope that Administrator Engeleiter might list as one of her priorities the enactment of my amendments to the Regulatory Flexibility Act to reinforce the belief that small businesses should not bear a disproportionate share of the regulatory burden. I look forward to hearing her views on these legislative issues and welcome the opportunity to work with her to reduce federal barriers which inhibit small business growth and development.

Senator **Lieberman**. Thank you.

Ms. Engeleiter, thank you for your testimony. I have found during the last couple of recesses when I have been home meeting with small business people, that there is a growing level of concern about the availability of conventional bank financing.

In some measure, this may be regional because we have had some troubles in banking in Connecticut in the last 6 months, but I suspect that it may also be national, and that is part of my question to you. I think it is in part a reaction to the S&L crisis. As a result, Federal bank regulators are looking very closely over the shoulder of the local banks.

They are imposing much tighter credit requirements, and as a result, small business people are having a very difficult time getting financing—at least that is what I have found in Connecticut.

So I wanted to ask you, first, whether you are finding similar problems and, as a result, whether you are receiving more applications for guaranteed loans through the SBA?

Ms. **Engeleiter**. Well, Senator, we are not really seeing yet an increase in guaranteed loan requests because of a lack of available credit.

Senator **Lieberman**. Right.

Ms. **Engeleiter**. But anecdotally, as I have been around the country and met with one of the Chambers of Commerce in your State, there does seem to be that sentiment. Recently, as an example, we had some meetings with the National Home Builders Association because home builders around the country seem to be experiencing a real shortage of credit right now. We are looking at our 7(a) Program which does allow participation of home builders but has some restrictions, to see how that program might be able to be helpful in terms of solving this problem.

But anecdotally, that is, what we are hearing out there, appears to be not only an increase in interest in the guarantee lending program, but also a lack of available venture capital as well. As I mentioned earlier, one of the studies that we will be doing within the Agency's Office of Advocacy will be to take a look at what is going on nationwide with regard to debt and equity financing so that we can better address these needs.

Senator **Lieberman**. Well, that would be particularly helpful to us, particularly the study of venture capital needs, as we consider the question—dare I mention the term—capital gains tax reductions in this session of Congress.

So what is your timetable on that assessment? Is that something that is going to be short-term, as in the next 2 to 4 months, or longer?

Ms. **Engeleiter**. No, it will not. These studies are very comprehensive and will not be done that fast. But I can tell you that based on studies we already have undertaken in the Office of Advocacy, the majority of small businesses in the Nation do not get financing from conventional lending institutions. They get it from informal capital, which we all know is subject to the capital gains tax.

The President's proposal of giving a benefit to those assets that are held for a longer period of time certainly is helpful to small businesses because our research shows that the average time that an investment in a small business is held is 5.1 years. This is according to a short-term study done by the Agency.

Senator LIEBERMAN. That is interesting. As you may know, the Chairman of this Committee had a brilliant and innovative proposal for a capital gains reduction during the last session, which would have been targeted to small businesses.

Just a final question along the lines of the 7(a) Guaranteed Loan Program and what I suspect may be, in the coming months, an increase in demand. Do you not think it is a tough time to be raising the fees? I gather you are proposing an increase of 2 percent to 5 percent which, explicitly, is a 150 percent increase, and my experience has been that folks—folks who have been turned down a couple of times by banks they have hope, but they are not very liquid.

Ms. ENGELEITER. Well, I appreciate your comments, Senator. Again, I would just say that on our average 7(a) loan this fee increase translates to an increase of $75 a month in the loan payment. That may sound sort of cruel and heartless, but in the interest of trying to come up with more money to have the program available to more people, this was one of our solutions.

You might be interested to know that the Agency currently has 68,000 7(a) guaranteed loans outstanding for $7.9 billion. The Government throughout the history of the program has guaranteed more than $34 billion in the 7(a) Loan Program. So this represents an awful lot of help to a lot of people.

Senator LIEBERMAN. It is.

Ms. ENGELEITER. But I appreciate your concern.

Senator LIEBERMAN. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Kasten.

## STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. Mr. Chairman, first I would like to just take a moment if I could to commend my fellow Wisconsinite——

The CHAIRMAN. Senator Kasten, I have been told by staff that you were here first and then you left.

Senator KASTEN. I was making a phone call.

The CHAIRMAN. That is why I am recognizing you. I just want to make sure that is recognized.

Senator KASTEN. No, I was just in the back making a phone call.

I want to thank Susan for the job that she is doing in her first year as the Administrator of the SBA, and I believe you have run the Agency with great skill and both the economy and the American people and small businessmen and women across this country are better off as a result.

I think that the SBA is stronger and more effective, and I am hopeful that you are going to continue the fine leadership that you have given so far.

And it is also important, I think, Mr. Chairman, we can look at the result- we have got a very solid budget for the SBA.

I think it is clear that the President recognizes the importance of the SBA. I think that this budget is one that is going to help small businesses continue to grow, and I believe that we have got less work to do, if you will, than we have in the past, where we have had to add back a whole lot of different kinds of programs, and I think we are closer to an honest budget in terms of the direction that we are going to be going in, and I think that is in part due to Susan's leadership.

This loan origination fee increase from 2 percent to 5 percent, I believe, has been before us for the last 4 or 5 years. It is in that list, that one book at OMB, they just xerox it and put it back in. And in my judgment, this Committee will not approve the difference from 2 percent to 5 percent.

We believe strongly that this in effect is a tax increase. Mr. Darman might not call it a duck but it looks like a duck from this side of the table, and I think that this Committee is unlikely to go along with that loan origination fee increase from 2 percent to 5 percent. And at least from my point of view, I am going to work to see that we do not approve that part of your request.

I want just to ask one question about SBICs, but I also want to associate myself with the views of the Senator from Connecticut and others with regard to the 7(a) Guaranteed Loan Program.

Loan demand has exceeded budget authority, I think for the last 2 years. I know for the last 2 years, probably even more. I do not know, but it seems to me that the 7(a) loan funding authority may not be sufficient and we are going to have to look at that carefully because this is an important area.

But I do not want to repeat questions that I have heard three or four other people talk about with regard to the funding, whether it is sufficient or not.

With regard to the SBICs and the SBIC industry, they have suffered greatly in the mid-1980s. I have introduced legislation to reform the SBIC industry.

What is your current assessment, first of all of the SBIC programs, and also of any efforts that we might make working with you to reform SBICs?

Ms. ENGELEITER. Well, first of all, Senator, thank you very much for your kind comments. I very much appreciate that and if I might just make a quick comment on the 7(a) and then address your question on SBICs.

We do think for this fiscal year, that the $3.2 billion that was appropriated for 7(a) will be sufficient, but that is just based on statistics from the portion of the fiscal year that has passed. This could change as time goes on, but based on current activity this year, we hope that this level will be adequate for the next fiscal year as well.

As I have indicated in my statement and also indicated with regard to some other questions, the SBIC Program by and large has been a very helpful program. A very good, private/public partnership, if you will, trying to make available more venture capital. And there certainly is a growing need for that.

The program has had some problems as reflected in the fact that we are asking for position increases in our budget to go to the SBIC Program to help in the liquidation area. We do want to work with you to make that a better program and to make more venture capital available if it is indeed needed.

There are some problems. We do have a major study going on and we are well on our way in trying to remedy the problems. We have already put some very extensive changes in place in regard to the program's liquidation process which had some real problems.

I am hopeful that if there is a follow-up oversight hearing on that program, and the study is complete, and that should be quite soon, that we can work together to make it even a better program.

Senator KASTEN. I thank you. We look forward to working with you, particularly with the idea of being able to provide more venture capital in the whole area and possibly giving them some additional mechanisms to go out and raise money in the private sector, which then could be directed toward some of these small business investments.

Mr. Chairman, thank you.

The CHAIRMAN. Thank you, Senator Kasten.

Senator Levin.

## STATEMENT OF HON. CARL LEVIN, A U.S. SENATOR FROM THE STATE OF MICHIGAN

Senator LEVIN. Thank you, Mr. Chairman. Let me add my welcome and thanks for the kind of administration we have seen over at the SBA. We are all grateful for it.

Ms. ENGELEITER. Thank you.

Senator LEVIN. On page 16 of your budget estimate, that you prepared, I believe, for this Committee, there is a figure that I do not understand. It is the business loan figure under budget authority and for fiscal year 1990, it looks like $159 million?

Ms. ENGELEITER. Yes.

Senator LEVIN. Then it goes down to $3 million and then it goes back up to $133 million.

Ms. ENGELEITER. Where?

Senator LEVIN. On page 16.

Mr. ROSENBAUM. I do not have that page right in front of me.

Senator LEVIN. While you are looking at that, let me ask the Administrator a question.

You are proposing to cut the funding for the Small Business Development Centers from $50 million to $30 million. Have they not proven to be useful?

Ms. ENGELEITER. They have proven to be very useful, Senator. And again, to put a more positive spin on it, the President is asking for $30 million more for the program than he did last year, but I fully realize that he is asking for $20 million less than was appropriated for the program in fiscal year 1990.

The program has been one that has been very enthusiastically embraced by the State governments and by the private sector and some local governments, and indeed, there is more money going into the program this year, $75 million from State and local governments and the private sector than is coming from the Federal Government. We do think it is realistic to eventually have that program totally funded by the private sector and by State and local governments.

But we are enthusiastic about the program, and in fact, having been working to see to it that by the end of the fiscal year, all 50 States will have a Small Business Development Center.

Senator LEVIN. Isn't it going to be harder to do that with the budget reduction from last year?

Ms. ENGELEITER. We believe that the $30 million that we are asking for will be adequate in light of the private sector monies that are being generated.

Senator LEVIN. Did you ask the OMB for more and they reduced it to this?

Ms. ENGELEITER. Yes, sir.

Senator LEVIN. On the Small Business Innovation Research program——

Mr. ROSENBAUM. Senator, I can answer that first question if you would like me to.

Senator LEVIN. OK.

Mr. ROSENBAUM. Senator, the number you are referring to is the appropriation amount that we are requesting. It is an appropriation to a revolving fund. That fund is also comprised of fees and repayments generated from our loan portfolio. The $3 million request is the result of: 1, the request we have for the guarantee fee going from 3 percent to 5 percent. That will generate about $100 million in additional revenue to that fund. So in a sense, if the fee proposal is not passed, we will be asking the Appropriation Committee to provide an additional $100 million.

Senator LEVIN. Doesn't it have the similar effect in future years?

Mr. ROSENBAUM. Yes, it does. But we are looking in the out years at not only the fee increases but also the repayments being generated. We are experiencing reduction in the direct loan portfolio, and as the portfolio goes down in the out years, because of no new direct loans, we do not receive the same level of repayments.

Senator LEVIN. OK. On the SBIR I believe that you are planning or thinking about changing the direction of that program from one that reports directly to you to one that is going to report to an associate deputy administrator for special programs. Is that correct?

Ms. ENGELEITER. Yes, I am Senator, but if I might explain that a little more fully. The program right now,which sunsets in 1993, is essentially being treated as a Pilot Program. And in terms of day-to-day management of the program, while it was put into place so that it reports to the Administrator, in practicality it is not looked at on a daily basis by myself.

I think it is a tremendous program. In my remarks I indicated that we are finding that 20 percent of the products that are developed are going into the commercial market. It has been an outstanding program. In my view, the change would be an elevation of the program to make it a mainstream program under the SBA, and I would like to see the program made long-term, because it has expanded and has been very successful.

Senator LEVIN. Do you expect the Administration will be requesting that we permanently authorize it?

Ms. ENGELEITER. Yes, I would expect so.

Senator LEVIN. And do you think that changing the reporting from you to an associate deputy administrator does not downgrade the program?

Ms. ENGELEITER. No, I do not, Senator, not at all. I think it accentuates the program. In fact, the one complaint that we get about the program is that there are not enough marketing strategies to promote the program. I would add that in the legislative package that our Agency has offered, there is a provision to do away with the sunset and make this a permanent program.

Senator LEVIN. Just one question. On your disaster loan testimony, I think it is the 7(b) Program. Is that the number of the disaster loan?

Ms. ENGELEITER. Yes, 7(b).

Senator LEVIN. You were talking about FEMA and that anybody that is eligible for FEMA would what—anyone who is not eligible for FEMA will not necessarily, under your proposal, be able to get a 7(b) loan, is that correct? It depends on whether or not they can get credit elsewhere. If they can, they are not going to be eligible for a loan. If they cannot, then they are going to have to pay market rate. Is that your proposal, basically?

Ms. ENGELEITER. Our proposal is to raise the interest rate from 4 percent to about 8 percent for the disaster lending program.

Senator LEVIN. Raise it to market.

Ms. ENGELEITER. To market. That way, both the FEMA Program, SBA and other disaster programs are coordinated. When an individual comes to a disaster center after an unfortunate disaster, they will go through—if they can pay back or might be able to pay back a loan, they go through the SBA lending process; that is the process of filling out the forms to apply for a loan. If they do not qualify, they are automatically referred to FEMA Grant Program.

Senator LEVIN. I would rather reverse it. How do you become eligible for a FEMA grant? How flat on your back, totally horizontal, prone?

Mr. ROSENBAUM. Senator, the way the program works is that disaster assistance centers are established in response to a disaster. Disaster victims receive information about our loans at these centers. If they are eligible for a loan, they are generally eligible for a grant. We are a filter for the Grant Program.

If we arrive at the determination that we cannot provide the applicant credit because there is no reasonable assurance of repayment, then they are referred to the Family Grant Program. We are the threshold.

Senator LEVIN. If you are creditworthy, you are going to be paying market. If you are not creditworthy, then you get a FEMA grant? There is no one who slips through the cracks?

Mr. ROSENBAUM. No one should slip through the cracks.

Senator LEVIN. Are there not a whole lot of folks who might be creditworthy who are in very, very bad shape and who could use a break on their interest? I think that is what Senator Lott and others were getting to here. You are creating two very stark alternatives here. But is there not a whole group of people who might be able to get credit?

The CHAIRMAN. On the other hand, I might prefer to go to FEMA and get a grant.

Senator LEVIN. But if you can get credit, if you are in good enough shape that you can get credit, then all of a sudden you are going to pay market rate, even though you are in lousy shape.

Ms. **Engeleiter**. Senator, I would suggest that if there are going to be oversight hearings on our disaster program, that between now and that time we take a look at this issue very carefully for you and see what our best estimate as to how many people fit into that middle category.

Senator **Levin**. So, you will be looking at prior disasters and you will be telling us how many people got various kinds of support in those disasters that would be reallocated into your two either/or alternatives?

Ms. **Engeleiter**. We certainly can do that.

Senator **Levin**. OK, that would be great.

Thank you, Mr. Chairman.

[Material follows:]

## INFORMATION REQUESTED FOR THE RECORD
## SENATE SMALL BUSINESS COMMITTEE HEARING

Mr. Levin

Question: In your statement you talked about your proposal to raise the interest rate for the disaster lending program and two groups of disaster victims. One group includes victims who are creditworthy, pay market prices and get SBA loans. The other group are those who are not creditworthy, so they are eligible for FEMA grants. Please provide for the record an estimate of the number of victims who are creditworthy, who are in very bad shape and who could use a break on their interest rate.

Answer: We would have to perform a long, detailed study to estimate the number of victims that would fit in the middle category, but the following is a portion of the testimony that our Disaster Office provided to your Committee on April 4, 1990.

Increasing the interest rate for disaster loans to the cost of funds to the government will certainly have an adverse effect on some borrowers. At this time, 30% of the low interests disaster loans being made in the Hugoquake, are made with a 30 year term. Probably this group of borrowers would include those most likely to have difficulty paying a higher interest rate. For example, in the loans for Hurricane Hugo and the earthquake, thus far 30% of the low interest home loans made had 30 year (maximum) terms. Thus far in FY 1990, there have been approximately 27,500 low interest home loans approved. Therefore, approximately 8,250 loans could fall into this category. It would not be true in all cases of 30 year terms, however, because we try not to take every dollar a borrower has available for the loan repayment at the time of the loan request in recognition of the fact that circumstances change and unexpected expenses happen to everyone.

However, those borrowers whose entire cash available to repay a disaster loan is such that the only loan we can make now, even at 4% must have a 30 year maturity, will be unable to repay the same size loan at the higher rate. But, they are not being left without any assistance by the government. In some cases the amount of the loan can be reduced. And, if an individual's loan is declined by SBA for lack of repayment ability, they are automatically referred to the IFG program for a grant. At this time, grants can be as much as $10,400. And in appropriate cases, a partial loan can be combined with a grant.

The CHAIRMAN. Senator Nunn.

## STATEMENT OF HON. SAM NUNN, A U.S. SENATOR FROM THE STATE OF GEORGIA

Senator NUNN. Thank you. I just want to ask one question. I have been involved for quite a while in the SBA Surety Bond Program, and particularly the program that we call the Preferred Surety Bond Guarantee Program. And of course, this is the program that was enacted into law November 3, 1988, and we had the support of SBA and the surety community,and yet it expires September 30, 1992. So, we do not have very much longer before it expires, and yet the disadvant aged small business community and the small business community are still waiting the writing of the first bond under the program. So, for a program that had the support of the industry and SBA and the Congress to take this long to get off the ground is disturbing.

I have got a letter, and I understand you have recused yourself on this program because, I guess, of your husband's activities, but I would like for you at least to ask the staff to take a look at this detailed letter and see if we cannot accelerate this. There is an awful lot of people out there who had high hopes, and all of us here on Capitol Hill who participated in the drafting of that, thought we were giving industry what they wanted, and thought that they were really going to take off with it once they got it, and I have, I must say, been very disappointed that nothing has happened. I do not fault SBA, necessarily, but I do hope that you will at least tell your staff to give this matter high-priority attention.

Ms. ENGELEITER. Well, Senator, I really appreciate your concerns, and while I am recused from making decisions regarding the regulations and how they are written, I do have the responsibility to see to it that the program stays on track. Since I have came to the SBA in May of last year, we have done some things to try to accelerate the process, and the final regulations are done. They are at the Office of Management and Budget now, and we hope to have clearance very shortly on those regulations. A copy has gone to the Federal Register to notify surety companies that we are interested in having them involved.

And in fairness to the program people at SBA, the portion of the law that mandated that the Agency work very closely with the companies has been very helpful, but perhaps has slowed it down a little bit. I think you will be pleased that things are moving along and should be implemented very shortly.

Senator NUNN. Well, that is good news. I hope that since the businesses have been so involved in the legislation, that the surety companies in the legislation and in the regulation that there certainly, hopefully will not be a delay. They should be ready to go. And I think it is really an opportunity for the surety companies to show what they can do in this area.

And in all of my contacts with particularly the small business community and the small disadvantaged business community, this is one of the most important problems they have, is getting surety bonds and getting off the ground and getting credit established and being able to perform. So to me, this is a very high priority area and I am delighted that you are going to at least be giving it some emphasis.

Ms. ENGELEITER. We will be giving it some emphasis, Senator, and we do have letters of intent that are already drafted from three surety companies to participate in the program, that they are all set to go now that the regulations are done.

Senator NUNN. Good. We will be talking later this spring. I think, Mr. Chairman, I will be working with you to chair a hearing on the SBDC Program, and I look forward to going into that in detail at that time. I will not ask any questions now, but I think we got a favorable GAO report on that program. That was good news to me, and I look forward to having hearings on that.

The CHAIRMAN. We did indeed. It took a long time, Senator Nunn, to get that report and I must say that I was mildly apprehensive about how well they were performing, but it was a fairly glowing report. Ms. Engeleiter did not read it. She is cutting $30 million out of that budget. [Laughter.]

I am sorry, $20 million, cutting it from $50 to $30 million. I am sure it is just an oversight on her part. [Laughter.]

Ms. ENGELEITER. And into giving more elaborate response to Senator Levin's question before, we did ask for $50 million.

The CHAIRMAN. Ms. Engeleiter, we are going to have to go vote. Just a couple of quick questions. You say that 23.5 percent of the people in this country live in rural counties. What is the definition of a rural county?

Ms. ENGELEITER. That is a definition that is used by the Department of Agriculture, and I do not know it off the top of my head.

Mr. ROSENBAUM. Mr. Chairman, we will be glad to provide it for the record.

[Material follows:]

## INFORMATION PROVIDED FOR THE RECORD
## SENATE SMALL BUSINESS COMMITTEE

Chairman Bumpers

| | |
|---|---|
| Question: | What is the definition of a rural county? |
| Answer: | The definition of a rural county is provided below. |

"Rural Area means:"

(1) Any political subdivision or unincorporated area in a nonmetropolitan county (as defined by the Economic Development Division, Economic Research Service, U.S. Department of Agriculture) or the Equivalent thereof which subdivision or area has a resident population of less than 20,000; or

(2) Any political subdivision or unincorporated area in a metropolitan county or the equivalent thereof, with a resident population of less than 20,000 if SBA has determined such political subdivision or area to be rural. (Authority: 15 U.S.C. 687(C) 695,696,697A, 697B, 697C, Pub. L. 100-590, Section 108.2)

The Office of Business Development generally has used the broader definitions of nonmetropolitan counties as definitions for rural areas. The definitions of nonmetropolitan counties have been set by the Office of Management and Budget (OMB), based on the 1980 Census, and include the 6 following categories of counties:

- Urban population of 20,000 or more, adjacent to metropolitan area
- Urban population of 20,000 or more not adjacent to a metropolitan area
- Urban population of less than 20,000, not adjacent to a metropolitan area
- Urban population of less than 20,000, adjacent to a metropolitan area
- Completely rural, adjacent to a metropolitan area
- Completely rural, not adjacent to a metropolitan area.

The **Chairman**. Let me also ask you about exports. The other day, one of my constituents called and said he had a chance to sell trucks to Peru and he did not know how to go about doing it.

And I called my staff member in Little Rock, who is my liaison with SBA, and I asked him if they had anybody that knew anything about exports up there, and he said no, that we do have a representative from the Commerce Department here, and he is very good.

And I called him, he called the constituent, and as far as I know, everything is right on track. My constituent called me back to thank me and said, this guy is really great. He knows everything, told me what to do, and he is going to help me follow through with it.

Do we not have people who can assist with exporting in these State offices?

Ms. **Engeleiter**. No, we do not. We do not have personnel who know much about Peru or any other foreign country. We have people who can, to a limited degree do that in the regional offices. We do make referrals to the Department of Commerce. We have the export financing that we can make available. Some of the SBDCs do have technical assistance that they can provide. We do have some SCORE volunteers who have extensive exporting backgrounds, but that is sort of hit and miss. We do not have a comprehenive system as does the Department of Commerce with their foreign and commercial service to make that assistance available.

I met about 2 weeks ago with Secretary Mosbacher and we agreed that we need to redo the memo of understanding between the Department of Commerce and the Small Business Administration to try and do the most with the resources that each Agency has to help people in the area of exporting. The level of cooperation has been quite good to date. We also do matchmaker trade missions together, but we need to do a lot more to raise awareness. For instance, we must assure that the Department of Commerce employees are aware of our exporting financing programs. It is a very cooperative relationship.

The **Chairman**. I was impressed with the number of seminars. We had one of those in Little Rock about 3 or 4 years ago, extremely well attended, and small business turned out in mass because a lot of them were curious, and it is sort of alien to them and it frightens them. And I think these seminars really serve a useful purpose.

Ms. **Engeleiter**. We have done a lot of those seminars. We will certainly continue, and we do it in cooperation with the Department of Commerce in many instances. As I believe you are aware, we are putting on a major seminar in Seattle at the end of the month. This seminar was mandated by the Trade Act of 1988.

In the area of training, we can do a fair amount, but in terms of having Agency personnel who have any expertise in terms of a foreign nation, we do not have that.

The **Chairman**. The Committee will stand in recess for about 15 minutes while I go vote, and then we will come back and hear from the Inspector General, Mr. Gillum.

Susan, Larry, thank you both very much.

Ms. **Engeleiter**. Thank you very much, Mr. Chairman.

[Recess.]

The **Chairman**. Inspector General Gillum, we are pleased to have you this afternoon and look forward to your testimony. I apologize for having to take off and keep you waiting.

## STATEMENT OF CHARLES GILLUM, INSPECTOR GENERAL, U.S. SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY STEVE SWITZER, ASSISTANT INSPECTOR GENERAL FOR AUDITING; AND STEVE MARICA, ASSISTANT INSPECTOR GENERAL FOR INVESTIGATIONS, SBA

Mr. **Gillum**. Thank you, Mr. Chairman. If I might, we submitted a lengthy statement for the record and if I could summarize it.

The **Chairman**. Please.

Mr. **Gillum**. With me this afternoon is Steve Switzer, our Assistant Inspector General for Auditing and Steve Marica, our Assistant Inspector General for Investigations.

It is a pleasure for me to be here today in response to your letter of February 22, 1990, inviting testimony on the President's budget proposal for the Small Business Administration and on reauthorization of the Agency's programs.

My comments represent my views and those of the SBA Office of Inspector General, and not necessarily those of the Administration. My statement, which has been submitted for the record, has not been subject to coordination or approval by OMB or the Agency.

I am pleased to be able to discuss the activities of my office. While preparing for this hearing, it became clear to me that our investigation operations have made outstanding progress, and while we have made good progress with our audit operation, we have a long way to go in delivering a high-quality audit program.

In our semiannual reports to Congress over the last 2 years, we have emphasized two recurring themes. The first has been our efforts to operate with limited, even diminishing resources, and the second is focused on our need to improve audit operations by shifting from our emphasis on SBIC examinations to a more balanced audit coverage for all Agency programs.

Each of these has a bearing on everything we will discuss today. You asked that we comment on the state of SBA's financial programs, the Small Business Capital Ownership Development Program and our review of the licensee known as River Capital Corp. While we have not audited the Agency's financial programs as extensively as we would have liked, we have some insights and concerns based upon our own audits, the work of our investigators, Agency Financial Integrity Act reports and recent studies by outside consultants. Our concerns with SBA's financial programs and the 8(a) programs are as much due to what we do not know about them as what we do know.

**Questions remain regarding the adequacy of resources to monitor the financial exposure represented by these programs. The consulting firm's studies are impressive and should help in providing an understanding of existing strengths and weaknesses. In addition, my office is committed to ensure adequate audit coverage of all Agency financial programs.**

Our examination of River Capital Corp. began in 1988, but we did not issue a final report, because the licensee was placed in liquidation status. River Capital's major problems related to its accounting practices. Notes of stock were accepted instead of writing off overdue interest, and unreasonably high values for its investments were established by its board of directors.

These practices distorted the income statement and balance sheet. The CPA firm that did the annual financial audit did not identify and report these deficiencies to Agency officials, who rightfully place reliance on such report when making programmatic judgments.

As to the budget and staffing of my office, this is the first year that we have had a separate appropriations account. That, along with Gramm-Rudman adjustments and the pay raise, has made things tight. Our current appropriation of $7.4 million cannot fund our authorized strength of 131 permanent and 8 temporary employees. As a result, we stopped backfilling positions some time ago, and now have 10 percent of our positions vacant. If fully funded, $8.7 million would be required, and an increase to $9.8 million, as requested in the President's budget for fiscal year 1991, is considered modest under these conditions. It would, however, enable us to address a number of critical areas of concern.

Our investigative jurisdiction includes over 100,000 borrowers, 500 SBICs, 3,000 8(a) firms, 3,800 permanent SBA employees, 56 SBDCs and a fluctuating number of disaster assistance employees.

Annually, we now receive about 600 complaints, open about 215 investigations, refer another 90 or so to other agencies for investigation and close out about 170 cases each year. If we open no new cases from now on, it would take about 2 years to clear our current inventory of major cases in our investigation inventory.

On the audit side, mandated work consumes about two-thirds of our available staff years. The effect of this has been to greatly extend internal audit cycles or to provide no audit coverage at all to some programs and activities. We would like to have more of a balanced program, do external audits better and, at the same time, give increased attention to the Agency's other auditable entities.

Our goals for 1990 and beyond are to institute an effective quality assurance program of nonFederal audit work; improve audit coverage of all programs to the elimination of mandated audit cycles and the programming of audit work based on priority criteria factors, such as risk, vulnerability, and dollar magnitude; support the adoption of good audit tracking and resolution procedures; promote professional development opportunities, law enforcement authority and safety for our investigators; leverage increased support from other agencies, such as the FBI, by direct referral and joint investigations; promote increased awareness of fraud abuse by our SBA employees; and engage in preventive activities, such as proactive investigations and the analysis of completed audits and investigations to identify possible trends or issues which have broad or more meaningful implications.

In closing, I would like to respond to the Chairman's concerns regarding a Department of Justice opinion, known as the KMIEC opinion, which purports to limit OIG investigative jurisdiction to those situations involving U.S. funds and employees. Although this opinion has had no known adverse effect on my office to date, I too have concerns and believe the attention of the Congress is most timely.

I appreciate the opportunity to appear, and would be pleased to respond to any questions.

[The prepared statement of Mr. Gillum follows:]

SBA U.S. Small Business Administration Washington, DC 20416

STATEMENT OF
CHARLES R. GILLUM
INSPECTOR GENERAL
U.S. SMALL BUSINESS ADMINISTRATION
BEFORE THE
COMMITTEE ON SMALL BUSINESS
U.S. SENATE
MARCH 8, 1990

GOOD AFTERNOON, MR. CHAIRMAN AND MEMBERS OF THIS COMMITTEE. I AM HERE TODAY IN RESPONSE TO YOUR LETTER OF FEBRUARY 22, 1990, INVITING TESTIMONY ON THE PRESIDENT'S BUDGET PROPOSAL FOR THE SMALL BUSINESS ADMINISTRATION, AND ON REAUTHORIZATION OF THE AGENCY'S PROGRAMS. MY COMMENTS REPRESENT MY VIEWS AND THOSE OF THE SBA OFFICE OF INSPECTOR GENERAL, AND NOT NECESSARILY THOSE OF THE ADMINISTRATION. MY STATEMENT, WHICH HAS BEEN SUBMITTED FOR THE RECORD, HAS NOT BEEN SUBJECT TO COORDINATION WITH OR APPROVAL BY OMB OR THE AGENCY.

## INTRODUCTION

I AM PLEASED TO HAVE THE OPPORTUNITY TO VISIT WITH THE COMMITTEE ON SMALL BUSINESS TO DISCUSS THE ACTIVITIES OF THE OFFICE OF INSPECTOR GENERAL (OIG) FOR THE LAST TWO YEARS. THESE HAVE BEEN REWARDING YEARS DURING WHICH WE HAVE HAD SOME NOTABLE ACCOMPLISHMENTS WHILE FACING, AT THE SAME TIME, A NUMBER OF CHALLENGES IN THE FORM OF SERIOUSLY NEEDED IMPROVEMENTS IN OPERATIONAL DIRECTION AND QUALITY. WE ARE ADDRESSING THESE AS VIGOROUSLY AS TIME AND RESOURCES WILL ALLOW.

### CHALLENGES

IN PREPARING FOR THIS HEARING IT BECAME CLEAR TO ME THAT WE HAVE MADE OUTSTANDING PROGRESS IN OUR INVESTIGATIONS OPERATIONS OVERALL--WE HAVE A CADRE OF HIGHLY QUALIFIED PROFESSIONALS WHO RECOGNIZE THE NEED FOR CONTINUING PROFESSIONAL DEVELOPMENT AND WHO NEED TO TAKE A BACK SEAT TO NO ONE IN WORKING COMPLEX INVESTIGATIONS. WHILE WE ARE MAKING NOTABLE HEADWAY WITH OUR AUDIT OPERATIONS, THE YEARS OF NEGLECT OF OUR INTERNAL AUDIT PROGRAM HAVE COME CLOSE TO IMPAIRING OUR ABILITIES TO RESPOND TO THE SWEEPING NATURE OF YOUR INQUIRY.

FOR THOSE WHO ARE FAMILIAR WITH OUR SEMIANNUAL REPORTS TO CONGRESS OVER THE LAST COUPLE OF YEARS, TWO RECURRING THEMES HAVE BEEN EVIDENT. THE FIRST HAS FOCUSED ON OUR EFFORTS TO CARRY OUT OUR OPERATIONS WITH LIMITED PERSONNEL RESOURCES AND TIGHT FUNDING FOR

TRAVEL, TRAINING, AND CONTRACTING, WHICH IS PRIMARILY FOR AUDIT WORK PERFORMED BY THE DEFENSE CONTRACT AUDIT AGENCY, AND PERSONNEL SECURITY INVESTIGATIONS BY THE OFFICE OF PERSONNEL MANAGEMENT. I WOULD LIKE TO DISCUSS OUR LIMITED RESOURCES IN GREATER DEPTH LATER ON IN MY TESTIMONY, BUT LET ME SAY FOR NOW THAT THE PRESIDENT'S BUDGET FOR FY 1991, AS PROPOSED, WOULD GO A LONG WAY TOWARD SOLVING MANY OF THESE ISSUES.

THE SECOND RECURRING THEME HAS BEEN THE NEED TO IMPROVE AUDIT OPERATIONS BY CHANGING FROM WHAT WAS ESSENTIALLY THE CONCENTRATION OF CRITICAL AUDIT RESOURCES ON ONE PROGRAM--THE EXAMINATION OF SBICS--TO PROVIDING FOR AUDIT COVERAGE OF ALL AGENCY PROGRAMS IN ACCORDANCE WITH THE STANDARDS OF THE GENERAL ACCOUNTING OFFICE (GAO), THE PRESIDENT'S COUNCIL ON INTEGRITY AND EFFICIENCY (PCIE), AND THE INSPECTOR GENERAL ACT. MOST SIMPLY PUT, WE WANT TO COMMIT AUDIT RESOURCES BASED ON PRIORITIES DETERMINED BY SUCH FACTORS AS: VULNERABILITY, RISK, FINANCIAL EXPOSURE, AND THE CONCERNS OF AGENCY MANAGERS AND MEMBERS OF CONGRESS.

IT IS SOMEWHAT IRONIC THAT THE NEED TO CHANGE THE OVERALL DIRECTION OF OUR AUDIT PROGRAM EVOLVED FROM AN EVALUATION OR STUDY OF THE SBIC EXAMINATION PROGRAM WHICH THE MAJORITY AND MINORITY STAFF DIRECTORS OF THIS COMMITTEE ASKED ME TO PERFORM IN THE SPRING OF 1987 WHEN I WAS GOING THROUGH SENATE CONFIRMATION FOR THE POSITION OF INSPECTOR GENERAL. IN COMPLYING WITH THIS REQUEST, A NUMBER OF THINGS BECAME APPARENT:

- ALTHOUGH ABOUT 70% OF THE AVAILABLE AUDIT FTE AND 90% OF THE AVAILABLE AUDIT TRAVEL FUNDS WERE DEVOTED TO SBICS, LESS THAN 40% OF THE SBIC EXAMINATIONS RESULTED IN A FINDING OF ANY MAJOR SIGNIFICANCE.

- WE COULD NOT CONTINUE ON A BUSINESS-AS-USUAL BASIS, WHEREIN WE EXAMINED EACH SBIC EACH YEAR WITHOUT REGARD TO ANY MATERIAL OUTSIDE FACTORS SUCH AS PAST EXAMINATION EXPERIENCE, RISK, FINANCIAL EXPOSURE, COMPLAINTS, MANAGEMENT INTERESTS, AND CONCERNS OF THE AUDITORS.

- WE COULD NOT CONTINUE TO SPREAD OUR RESOURCES OVER THE ENTIRE UNIVERSE OF ACTIVE SBICS AND AS A RESULT COVER SOME THAT DID NOT NEED IT WHILE INVARIABLY SHORTCHANGING SOME REVIEW THAT SHOULD HAVE RECEIVED MORE EXTENSIVE COVERAGE. WORK HAD TO BE DONE SMARTER.

- CONTINUING AUDIT COVERAGE OF THE PROGRAM, HOWEVER, WAS ESSENTIAL, GIVEN THE NATURE AND PAST HISTORY OF THE PROGRAM.

THESE CONCLUSIONS ARE MEANINGFUL WHEN VIEWED IN THE CONTEXT OF OUR AUDIT PROGRAM OVERALL AND THE ACTIVITIES OF THE AGENCY. THE FINANCIAL EXPOSURE OF THE SBIC PROGRAM IS ABOUT $1.6 BILLION AND

IS EXTENSIVELY AUDITED. OTHER AGENCY PROGRAMS SUCH AS BUSINESS LOANS VALUED AT ABOUT $11 BILLION, DISASTER LOANS OF ABOUT $3.3 BILLION, MINORITY SMALL BUSINESS ACTIVITIES OF ABOUT $3 BILLION, AND CONTRACT AND COOPERATIVE AGREEMENTS TOTALING MORE THAN $75 MILLION, HAVE FOR ALL PRACTICAL PURPOSES GONE UNAUDITED.

BRINGING ABOUT THE MUCH-NEEDED NEW DIRECTION WAS MUCH EASIER TO SAY THAN TO DO, SINCE:

o PRIOR TO NOVEMBER 1988, SECTION 310(B) OF THE SMALL BUSINESS INVESTMENT ACT OF 1958 REQUIRED THAT SBICS BE EXAMINED ANNUALLY. SINCE NOVEMBER 1988 EXAMINATIONS HAVE BEEN REQUIRED ON A BIENNIAL BASIS;

o SBIC AUDIT WORK RECEIVED PRIORITY ATTENTION OVER ALL OTHER AUDIT WORK, AND AS A RESULT THE INTERNAL AUDIT PROGRAM AND AUDITORS DEDICATED TO INTERNAL AUDIT WORK WERE RELEGATED TO SECOND CLASS STATUS, NOT ONLY WHEN COMPETING FOR PERSONNEL RESOURCES BUT ALSO FOR TRAVEL, TRAINING, AND RELATED ACTIVITIES.

o OVERALL STAFFING HAS DECLINED OR FUNDING LIMITATIONS HAVE CONSTRAINED OUR ABILITY TO INJECT NEW TALENT AND VITALITY INTO THE WORKFORCE. FOR EXAMPLE, WE WENT FROM A HIGH IN AUTHORIZED STAFFING OF 133 FTE IN FY 1987 TO OUR CURRENT AUTHORIZATION OF 129 FTE FOR FY 1990. EVEN

THOUGH WE ARE AUTHORIZED 129 FTE, WE ARE HOLDING 13 POSITIONS VACANT BECAUSE CURRENT FUNDING WILL NOT SUPPORT THE AUTHORIZED LEVEL.

o IN A PERFECT WORLD AN AUDITOR IS AN AUDITOR IS AN AUDITOR. IN THE REAL WORLD THIS IS NOT UNIVERSALLY TRUE, AND THE REALITY IS THAT YOU CANNOT TAKE A WORKFORCE USED TO DOING EXTERNAL WORK, LIKE SBIC EXAMINATIONS, AND EXPECT THEM TO SHIFT OVERNIGHT TO INTERNAL AUDIT WORK, WHICH IS BY ITS NATURE MORE COMPLEX AND BROAD IN SCOPE.

o LITTLE EFFECTIVE AUDIT TIME, NO MORE THAN ONE-THIRD, REMAINS AVAILABLE FOR MEANINGFUL COVERAGE OF AGENCY PROGRAMS ONCE THE AUDIT WORK REQUIRED BY LAW IS PROGRAMMED ANNUALLY. MANDATED AUDIT WORK INCLUDES THE BIENNIAL EXAMINATIONS OF SBICS; ANNUAL AUDITS OF PREFERRED SURETY BOND PROGRAM PARTICIPANTS; ANNUAL REVIEW OF CONSULTANT AND ADVISORY SERVICES CONTRACTS; ANNUAL REVIEW OF LOBBYING ACTIVITIES; ACTIVITIES UNDER THE FEDERAL MANAGERS FINANCIAL INTEGRITY ACT; MONITORING OF THE QUALITY OF AUDIT WORK PERFORMED BY INDEPENDENT PUBLIC ACCOUNTANTS; AND AUDIT FOLLOW-UP ACTIVITIES REQUIRED BY THE IG ACT AMENDMENTS OF 1988.

## ACCOMPLISHMENTS

I DO NOT MEAN TO SOUND TOO PESSIMISTIC. QUITE THE CONTRARY, I BELIEVE THAT, WHILE WE HAVE MUCH TO DO, WE HAVE MADE NOTABLE PROGRESS ON MANY FRONTS WITH THE COOPERATION AND SUPPORT WE HAVE RECEIVED AT VARIOUS LEVELS OF GOVERNMENT, INCLUDING THE OFFICE OF MANAGEMENT AND BUDGET (OMB), AGENCY MANAGEMENT, AND THE CONGRESS. EXAMPLES INCLUDE:

- CHANGING THE EXAMINATION REQUIREMENT FOR SBICS FROM ANNUAL TO BIENNIAL, ALLOWING US TO DIRECT RESOURCES TO OTHER PROGRAM AREAS;

- MORE THAN DOUBLING THE NUMBER OF INDICTMENTS AND CONVICTIONS OUR INVESTIGATORS OBTAIN ON AN ANNUAL BASIS;

- MOVING FROM A CONCENTRATION ON EMPLOYEE MISCONDUCT CASES TO MORE COMPLEX FINANCIAL TYPE INVESTIGATIONS WHICH HAVE A GREATER POTENTIAL FOR PROSECUTION AND DOLLAR RECOVERIES;

- REORGANIZING OUR AUDIT DIVISION INTO ONE OPERATING GROUP TO ELIMINATE THE PREVIOUSLY EXISTING DISTINCTION BETWEEN INTERNAL AND REGULATORY AUDITORS;

- INITIATING TRAINING PROGRAMS TO PROMOTE PROFESSIONALISM, AND TO IMPROVE EFFICIENCY AND ECONOMY;

- UPGRADING AUDITOR AND INVESTIGATOR FIELD POSITIONS TO PROMOTE MORALE AND WELFARE AND TO BE COMPETITIVE WITH THE REST OF THE IG COMMUNITY IN THE RECRUITING AND RETENTION OF QUALITY PERSONNEL;

- ENGAGING IN MORE VIGOROUS AUDIT PLANNING, INCLUDING THE SOLICITATION OF THE VIEWS AND CONCERNS OF AGENCY MANAGERS, AND PUBLISHING AN ANNUAL AUDIT PLAN WHICH IS SHARED WITH AGENCY MANAGERS AND OTHER INTERESTED PARTIES;

- AGGRESSIVELY PLANNING INVESTIGATION ACTIVITIES ON AN ANNUAL BASIS TO ESTABLISH AND REFINE INVESTIGATION PRIORITIES AND CRITERIA; RECOGNIZING THAT IF WE CANNOT DO EVERYTHING THAT SHOULD BE DONE WE SHOULD TRY TO MAKE SURE THAT WE GIVE ATTENTION TO THOSE THINGS WHICH ARE MOST IMPORTANT; AND

- ACQUIRING COMPUTERS TO SUPPORT AND CARRY OUT AUDIT AND INVESTIGATION OPERATIONS.

## AGENCY FINANCIAL PROGRAMS

YOU HAVE ASKED THAT WE PROVIDE AN ASSESSMENT OF THE STATE OF THE AGENCY'S FINANCIAL PROGRAMS. WHILE WE DO NOT HAVE A BROAD BASE OF KNOWLEDGE BASED ON OUR OWN WORK, FOR REASONS WE HAVE ALREADY EXPLAINED, WE HAVE PERFORMED SOME RECENT AUDIT WORK IN THESE AREAS. THIS, ALONG WITH THE AGENCY'S FEDERAL MANAGERS FINANCIAL INTEGRITY ACT DISCLOSURES, INDEPENDENT AGENCY MANAGEMENT STUDIES, AND WORK PERFORMED BY OUR INVESTIGATORS, GIVES SOME INSIGHT INTO CERTAIN WEAKNESSES, INTERNAL CONTROLS, AND CONCERNS WITH RESPECT TO SOME ASPECTS OF THESE PROGRAMS.

### INVESTIGATIVE WORK

WE HAVE REVIEWED OUR INVESTIGATIVE CASELOAD, USE OF RESOURCES, AND RESULTS FOR THE PAST SEVERAL YEARS TO DETERMINE THE LEVEL OF INVESTIGATIVE EFFORT DEVOTED TO THE AGENCY'S FINANCE PROGRAMS. OF OUR CURRENT INVENTORY OF 210 CASES, 86 DEAL WITH THE BUSINESS LOAN PROGRAM, 14 INVOLVE INVESTMENT COMPANIES, AND 17 INVOLVE THE DISASTER LOAN PROGRAM. THIS WORKLOAD ACCOUNTS FOR APPROXIMATELY 60% OF OUR AVAILABLE INVESTIGATIVE STAFF TIME. IN FY 1989, WE OBTAINED 26 INDICTMENTS AND 19 CONVICTIONS IN CASES RELATING TO THESE AGENCY PROGRAMS, AS WELL AS $23.7 MILLION IN DOLLAR ACCOMPLISHMENTS.

WHILE WE HAVE HAD A MEASURE OF SUCCESS, AS DEMONSTRATED BY THE ABOVE STATISTICS, IN INVESTIGATING AND PROSECUTING ALLEGATIONS OF

FRAUD IN THE AGENCY'S FINANCE PROGRAMS, THIS WORK BY ITS NATURE IS CASE-ORIENTED AND NOT ALWAYS AN APPROPRIATE BASE FROM WHICH TO FORM CONCLUSIONS ABOUT THE HEALTH OF THE PROGRAMS AS A WHOLE. IT IS, HOWEVER, A CONSTANT REMINDER THAT THESE PROGRAMS ARE VULNERABLE BECAUSE MONEY IS INVOLVED.

## MANAGEMENT AND AUDIT ANALYSES

ON A MORE SYSTEMIC LEVEL, SBA HAS SUBMITTED COMPREHENSIVE REPORTS TO THE PRESIDENT AND CONGRESS ON THE AGENCY'S INTERNAL CONTROL SYSTEMS AND THE RESULTS OF INTERNAL REVIEWS OF THE APPLICATION OF THOSE CONTROLS. SINCE 1984, THE AGENCY HAS IDENTIFIED AND REPORTED 81 MATERIAL WEAKNESSES IN ITS SYSTEMS AND PROGRAMS, OF WHICH 66 HAVE BEEN CORRECTED AND THE REST ARE SCHEDULED FOR CORRECTION EITHER THIS FISCAL YEAR OR IN FY 1991. WEAKNESSES IDENTIFIED HAVE COVERED VIRTUALLY ALL SBA PROGRAMS, AND THE RESULTS ACHIEVED BY MANAGEMENT IN CORRECTING THE IDENTIFIED WEAKNESSES DEMONSTRATES THE AGENCY'S COMMITMENT TO SOUND MANAGEMENT. THE 15 MATERIAL WEAKNESSES IDENTIFIED IN THE MOST RECENT REPORT FOR FY 1989 DESCRIBED DEFICIENCIES IN THE FINANCE AND INVESTMENT, 8(A), AND SMALL BUSINESS DEVELOPMENT CENTER PROGRAMS.

OUR OWN PAST AND ONGOING AUDIT WORK AND THAT OF GAO HAVE IDENTIFIED THREE AREAS OF CONCERN. THESE ARE: (1) SBA'S PREFERRED LENDER PROGRAM FOR 7(A) LOANS; (2) THE AGENCY'S PROCESSES FOR LIQUIDATING COLLATERAL ACQUIRED BY SBA DURING THE COURSE OF ITS PROGRAMS; AND

(3) THE NEED FOR A QUALITY ASSURANCE PROGRAM BY THE INSPECTOR GENERAL TO REVIEW AUDIT WORK BY INDEPENDENT PUBLIC ACCOUNTANTS.

PREFERRED LENDER PROGRAM

OUR PRELIMINARY WORK TO DATE ON SBA'S PREFERRED LENDER PROGRAM FOR 7(A) LOANS, INCLUDING REVIEWS OF LENDERS UNDER THE JURISDICTION OF SBA FIELD OFFICES IN VERMONT, FLORIDA, TEXAS, AND CALIFORNIA, SUGGESTS SOME AREAS IN WHICH IMPROVEMENTS CAN BE MADE. THE REACTIONS OF FIELD MANAGERS TO OUR INITIAL FINDINGS HAVE BEEN FAVORABLE, AND WE ANTICIPATE THAT WE WILL ISSUE REPORTS ON THESE AUDITS OVER THE NEXT TWO TO THREE MONTHS. AN OVERALL REPORT WILL THEN BE PREPARED FOR SBA SENIOR PROGRAM MANAGERS.

LIQUIDATION OF COLLATERAL

ANOTHER AREA OF CONCERN TO US IS THAT THE LIQUIDATION PROCESS FOR COLLATERAL ACQUIRED BY SBA TAKES TOO LONG, NEEDS TO BE MORE EFFECTIVELY MANAGED, AND NEEDS MORE EFFECTIVE FINANCIAL CONTROLS TO ENSURE THAT MONIES RECEIVED ARE PROPERLY CONTROLLED. OUR AUDIT OF THE LIQUIDATION OF ROYAL BUSINESS FUNDS CORPORATION, FOR EXAMPLE, FOUND THAT DELAYS IN THE LIQUIDATION PROCESS CAN BE COSTLY TO THE AGENCY. LIKEWISE, OUR AUDIT OF THE MAINTENANCE AND DISPOSITION OF COLLATERAL AT THE NEWARK, NEW JERSEY FIELD OFFICE DISCLOSED THAT THE LACK OF ATTENTION CAN LEAD TO SUBSTANTIAL DETERIORATION OF ASSETS AND OTHER FINANCIAL LOSSES RELATED TO THE CONDITION OF THE ASSETS WHEN THEY ARE SOLD. IN BOTH OF THESE CASES, IT SHOULD BE NOTED, THE ADMINISTRATOR AND AGENCY MANAGERS

HAVE REACTED POSITIVELY AND PROMPTLY IN INITIATING CORRECTIVE ACTIONS.

- IN AUGUST 1989 WE ISSUED AN AUDIT REPORT ON THE LIQUIDATION OF ROYAL BUSINESS FUNDS CORPORATION, A SMALL BUSINESS INVESTMENT COMPANY. WE REPORTED THAT THE LIQUIDATION OF THE SBIC'S PORTFOLIO ASSETS HAD NOT BEEN EXPEDITIOUSLY PURSUED AS CALLED FOR BY AGENCY STANDARD OPERATING PROCEDURES, THAT FUNDS GENERATED DURING THE LIQUIDATION PROCESS HAD NOT BEEN PROPERLY ACCOUNTED FOR OR MAINTAINED IN APPROPRIATE ACCOUNTS UNDER THE CONTROL OF SBA'S COMPTROLLER, AND THAT SBA TOP MANAGEMENT HAD NOT BEEN APPROPRIATELY INFORMED OR MADE A PART OF THE LIQUIDATION DECISION-MAKING PROCESS. AS A RESULT, THE LIQUIDATION PROCESS HAS EXTENDED OVER A LENGTHY PERIOD (NEARLY 8 YEARS AT THIS TIME), MILLIONS OF DOLLARS OF EXPENDITURES OR DEPOSITS WERE NOT SUPPORTED BY APPROPRIATE DOCUMENTATION, AND WE ESTIMATED THAT SBA WOULD ULTIMATELY LOSE IN EXCESS OF $10 MILLION IN THE LIQUIDATION.

  AGENCY MANAGEMENT AGGRESSIVELY RESPONDED TO OUR RECOMMENDATIONS. IN ADDITION, AN OVERALL ASSESSMENT OF SBA'S SBIC LIQUIDATION PROGRAM WAS PERFORMED BY AN INDEPENDENT CONSULTING FIRM AT THE DIRECTION OF THE ADMINISTRATOR AND HAS FORMED THE BASIS FOR IMPROVEMENTS

IN THE LIQUIDATION PROCESS. THE ASSESSMENT ESSENTIALLY CONFIRMED THE PROGRAMMATIC CONDITIONS WE REPORTED WITH RESPECT TO ROYAL BUSINESS, AND MORE IMPORTANTLY, SHOWED THAT THE CONDITIONS APPLIED TO THE LIQUIDATION PROGRAM OVERALL.

o IN SEPTEMBER 1989 WE ISSUED AN AUDIT REPORT ON THE MAINTENANCE AND DISPOSITION OF COLLATERAL AT THE NEWARK, NEW JERSEY FIELD OFFICE. WE REPORTED THAT FIVE ITEMS OF ACQUIRED COLLATERAL HAD BEEN IN INVENTORY AND UNSOLD FOR PERIODS RANGING FROM EIGHT MONTHS TO EIGHT YEARS. ONE ASSET, ACQUIRED IN 1981, HAD SEVERELY DETERIORATED WHILE THE BORROWER WAS ALLOWED TO OCCUPY THE PROPERTY RENT-FREE. THIS PROTRACTED DISPOSAL AND FAILURE TO PRESERVE THE PROPERTY RESULTED IN A LOSS TO THE GOVERNMENT AND AN ECONOMIC BENEFIT TO THE PERSON WHO HAD DEFAULTED ON THE SBA LOAN.

ONCE AGAIN, AGENCY MANAGEMENT RESPONDED PROMPTLY TO OUR RECOMMENDATIONS BY INCREASED MONITORING OF THE PROPERTY DISPOSAL PROCESS.

## QUALITY REVIEWS OF IPA AUDITS

THE THIRD AREA OF CONCERN THAT WE HAVE IDENTIFIED PERTAINS TO IMPROVEMENTS NEEDED WITH RESPECT TO MONITORING THE QUALITY OF AUDIT WORK PERFORMED BY CERTIFIED PUBLIC ACCOUNTANTS (CPAS), PARTICULARLY

THE AUDITED FINANCIAL STATEMENTS OF SMALL BUSINESS INVESTMENT COMPANIES. I BELIEVE THAT THIS CONCERN CAN BEST BE ADDRESSED IN THE CONTEXT OF OUR REVIEW OF RIVER CAPITAL CORPORATION, WHICH ILLUSTRATES SOME OF THE PROBLEMS WITH THE CURRENT SYSTEM AND POINTS THE WAY TO POTENTIAL SOLUTIONS.

## RIVER CAPITAL CORPORATION

YOU HAVE ASKED THAT I DISCUSS THE RESULTS OF OUR REVIEW OF RIVER CAPITAL CORPORATION, A SMALL BUSINESS INVESTMENT COMPANY, WHICH DEFAULTED ON $28.5 MILLION IN SBA GUARANTEED DEBENTURES. YOU HAVE ALSO REQUESTED THAT WE PROVIDE THE COMMITTEE WITH A COPY OF DOCUMENTS WE HAVE PREPARED REGARDING RIVER CAPITAL. WE ARE COMPLYING BY SEPARATE LETTER, AND APPRECIATE THE CHAIRMAN'S ASSURANCES THAT THESE MATERIALS, WHICH ARE PREDECISIONAL IN NATURE, WILL NOT BE MADE PUBLIC AT THIS TIME.

### REVIEW RESULTS

WE BEGAN AN EXAMINATION OF RIVER CAPITAL IN JULY 1988. WE DID NOT ISSUE A FINAL REPORT ON THE RESULTS OF OUR EXAMINATION BECAUSE RIVER CAPITAL WAS TRANSFERRED INTO LIQUIDATION STATUS. WE DID PROVIDE A COPY OF A DRAFT REPORT TO THE INVESTMENT DIVISION AND OFFICE OF GENERAL COUNSEL, AND ONE OF OUR PRINCIPAL RECOMMENDATIONS WOULD HAVE BEEN TO PLACE RIVER CAPITAL IN LIQUIDATION HAD THIS NOT ALREADY BEEN DONE.

RIVER CAPITAL'S MAJOR PROBLEMS WERE RELATED TO ITS ACCOUNTING PRACTICES. RIVER CAPITAL'S BOARD OF DIRECTORS DID NOT WRITE-OFF OVERDUE INTEREST THAT RIVER CAPITAL WAS OWED BY SMALL BUSINESS CONCERNS, EVEN THOUGH THE INTEREST WAS OVERDUE FOR LONG PERIODS OF TIME AND THE SMALL BUSINESS CONCERNS DID NOT HAVE THE FINANCIAL CAPABILITY TO PAY INTEREST IN THE FORESEEABLE FUTURE. INSTEAD OF WRITING OFF THESE "BAD DEBTS," RIVER CAPITAL CONVERTED THE OVERDUE INTEREST INTO DEMAND NOTES OR STOCK OF THE CONCERNS, WHICH DISTORTED BOTH RIVER CAPITAL'S INCOME STATEMENT AND ITS BALANCE SHEET.

RIVER CAPITAL'S BOARD OF DIRECTORS ALSO ESTABLISHED VALUES FOR SOME INVESTMENTS WHICH, IN OUR OPINION, WERE UNREASONABLE. THE SBIC REGULATIONS PROVIDE THAT WHEN NO READY MARKET EXISTS FOR AN INVESTMENT SECURITY, THE VALUE IS TO BE DETERMINED IN GOOD FAITH BY THE BOARD OF DIRECTORS. MANY OF RIVER CAPITAL'S INVESTMENTS WERE IN COMPANIES THAT WERE IN SERIOUS FINANCIAL TROUBLE. BASED ON FINANCIAL STATEMENTS, TRENDS OF BUSINESS ACTIVITY, AND FAILURES TO PAY INTEREST TO RIVER CAPITAL, RIVER CAPITAL SHOULD HAVE WRITTEN MANY OF THE INVESTMENTS DOWN IN VALUE.

BOTH OF THESE ACCOUNTING DEFICIENCIES WERE NOT, IN OUR OPINION, APPROPRIATELY IDENTIFIED AND REPORTED UPON BY THE FIRM THAT PERFORMED RIVER CAPITAL'S ANNUAL FINANCIAL AUDIT. THE INVESTMENT DIVISION AND THE OFFICE OF INSPECTOR GENERAL MUST BE ABLE TO RELY

ON THE WORK OF NONFEDERAL AUDITORS, AND INADEQUATE WORK CAN HAVE SERIOUS EFFECTS, AS WE BELIEVE IS THE CASE WITH RIVER CAPITAL.

## PREVENTION OF FUTURE PROBLEMS

YOU HAVE ASKED WHAT CAN BE DONE TO PREVENT FUTURE PROBLEMS SIMILAR TO THOSE EXPERIENCED WITH RIVER CAPITAL. FIRST, THERE ARE SEVERAL APPROACHES AND LEVELS OF INCREASED CONTROL THAT WOULD HELP PREVENT OR DETECT ACCOUNTING DEFICIENCIES. THE GENERAL ACCOUNTING OFFICE ISSUED A REPORT IN MAY 1988 ENTITLED CPA AUDIT QUALITY - IMPROVED CONTROLS ARE NEEDED TO ENSURE QUALITY AUDITS OF FEDERAL LOAN PROGRAMS, WHICH INCLUDED AN ASSESSMENT OF AUDITS OF SBA LICENSEES BY CPAS. THE REPORT, WHICH ROUTINELY REFERRED TO SBA, IS IN REALITY CRITICAL OF BOTH AGENCY MANAGEMENT AND THE OIG. GAO REPORTED THAT SBA DID NOT HAVE EFFECTIVE CONTROLS FOR RECEIVING AND REVIEWING CPA AUDITS AND DID NOT PROVIDE ADEQUATE WRITTEN GUIDANCE FOR CPAS TO FOLLOW IN CONDUCTING THE AUDITS. GAO RECOMMENDED THAT SBA REVISE ITS APPROACH TO REQUIRE THAT AUDITS BY CPAS BE PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS (THE "YELLOW BOOK").

I AM PERSONALLY IN AGREEMENT WITH GAO AND, WHILE THERE MAY BE THOSE WHO HOLD A DIFFERENT VIEW, I BELIEVE IT IS CLEAR THAT THE OIG HAS NOT EFFECTIVELY FULFILLED ITS STATUTORY RESPONSIBILITY UNDER THE IG ACT (SECS. 4(B)(1), (2), AND (3)). IN THE MOST BASIC TERMS, THE IG HAS A DUTY TO ENSURE THAT WORK BY NON-FEDERAL AUDITORS COMPLIES

WITH GAO STANDARDS. WHILE THERE MAY BE REASONS FOR THESE SHORTCOMINGS, WE ARE NOT SATISFIED WITH OUR PROGRESS TO DATE. BECAUSE OF THIS WE ARE: (1) AGGRESSIVELY MOVING TO RECRUIT THE PERSONS(S) WITH THE SKILLS NEEDED TO PERFORM QUALITY ASSESSMENT REVIEWS; AND (2) CONTINUING TO PUSH FOR THE ADOPTION OF A REVISED AUDIT GUIDE REQUIRING THAT AUDITS BE PERFORMED AND REPORTED IN ACCORDANCE WITH GAO "YELLOW BOOK" STANDARDS. IMPLEMENTATION OF THESE MEASURES WILL IMPROVE THE MONITORING AND SUPERVISION OF LICENSEES IN SEVERAL WAYS:

- PROGRAM MANAGERS WILL RECEIVE MORE COMPREHENSIVE CPA AUDIT REPORTS AND CAN BE CONFIDENT OF THEIR QUALITY AND RELIABILITY;

- A BASE LEVEL OF CPAS WILL ESSENTIALLY PROVIDE COVERAGE ON AN ANNUAL BASIS, ALLOWING OIG WORK TO BE MORE FOCUSED AND COMPREHENSIVE AND THE IMPACT OF ANY REDUCTIONS IN THE NUMBER OF OIG AUDITS TO BE MINIMIZED; AND

- A MORE COMPREHENSIVE AUDIT COVERAGE SHOULD EVOLVE THROUGH MORE DIRECT INTERPLAY BETWEEN OIG AUDITORS AND PRIVATE SECTOR PRACTITIONERS PERFORMING THIS WORK.

TO GUARD AGAINST FUTURE PROBLEMS SUCH AS RIVER CAPITAL, WE ALSO BELIEVE THERE IS A NEED TO LOOK AT THE ORGANIZATION AND STAFFING

OF THE INVESTMENT DIVISION. THE INVESTMENT DIVISION'S $1.5 BILLION OPERATIONS ARE COMPLEX AND SIGNIFICANT, AND THE QUESTION AS TO WHETHER IT HAS THE ABILITY TO EFFECTIVELY MONITOR LICENSEE ACTIVITIES IS IMPORTANT. ADMITTEDLY, THE INVESTMENT DIVISION'S RESOURCES ARE SUPPLEMENTED BY SUPPORT THEY RECEIVE FROM THE OFFICE OF GENERAL COUNSEL AND THE OIG, BUT THESE ARE NOT A SUBSTITUTE FOR MONITORING BY THE PROGRAM MANAGERS. A SIGNIFICANT VALUE OF AUDITS IS DERIVED FROM THEIR INDEPENDENCE, AND WHILE MONITORING CAN HAVE SIMILAR ATTRIBUTES, IT PROVIDES THE MANAGER WITH A DIFFERENT AND MUCH-NEEDED KIND OF RESULT WITH WHICH TO MANAGE THE PROGRAM.

SBA MANAGEMENT HAS BEEN DEVOTING INCREASED ATTENTION TO THE MONITORING AND SUPERVISION OF LICENSEES. I AM NOT HERE TO BE A "PUBLIC RELATIONS FLAK" FOR MANAGEMENT, BUT I DO THINK IT IS IMPORTANT, IN OUR ZEAL TO FOCUS ON THOSE THINGS THAT REQUIRE ASSESSMENT OR CORRECTIVE ACTION, THAT WE NOT OVERLOOK A NUMBER OF POSITIVE STEPS BY MANAGEMENT WHICH SHOULD HAVE BENEFICIAL RESULTS IN PROMOTING EFFICIENCY AND ECONOMY. THE FIRST WAS A DECLARATION BY THE ADMINISTRATOR, ALMOST IMMEDIATELY UPON TAKING OFFICE, TO MAKE THE CLOSING OF OPEN AUDIT FINDINGS ONE OF HER PRIORITIES. THIS TOOK SHAPE IN THE FORM OF PROMPT ACTION BY THE ADMINISTRATOR ON OUR REPORT ON ROYAL BUSINESS FUNDS--A REPORT WHICH, IN MY VIEW, PRODUCED THE MOST SIGNIFICANT RESULTS OF ANY OIG AUDIT REPORT ISSUED OVER THE PAST SEVERAL YEARS. I NOTE THAT AMONG THESE ACTIONS WAS AN INCREASE IN AGENCY RESOURCES DEVOTED TO THE PORTFOLIO MANAGEMENT FUNCTION. JUST AS ENCOURAGING WAS THE PROMPT

ACTION WE RECEIVED FROM THE REGIONAL ADMINISTRATOR IN NEW YORK TO OUR REPORT ON THE MAINTENANCE AND DISPOSITION OF COLLATERAL IN THE NEWARK, NEW JERSEY OFFICE. EQUALLY IMPORTANT IN MANY WAYS HAS BEEN THE ADMINISTRATOR'S ENGAGEMENT OF TWO STUDIES BY IRVING BURTON ASSOCIATES, INC.--WHICH, AS AN ASIDE, IS A SUCCESSFULLY GRADUATED MINORITY-OWNED ACCOUNTING FIRM--OF ASPECTS OF THE MANAGEMENT OF THE SBIC PROGRAM. THESE ARE MANAGEMENT EVALUATION TYPES OF REVIEWS AND THE FIRST, WHICH FOCUSED ON THE LIQUIDATION OF SBICS, WAS MOST INFORMATIVE AND CONSISTENT WITH OUR FINDINGS IN OUR REVIEW OF ROYAL BUSINESS FUNDS. THE SECOND STUDY IS LOOKING AT HOW THE INVESTMENT DIVISION OPERATES AND WHAT MIGHT NEED TO BE DONE TO MAKE THINGS BETTER. WE HAVE MET WITH THE IRVING BURTON ASSOCIATES, INC. TEAM THAT IS PERFORMING THE STUDY AND WE ARE MOST INTERESTED TO SEE THEIR FINAL RESULTS. I BELIEVE THESE STUDIES ARE SIGNIFICANT MANAGEMENT ACTIONS THAT DESERVE ATTENTION AND CREDIT.

IN SUMMARY, OUR CONCERNS WITH THE FINANCIAL PROGRAMS ARE DUE IN LARGE MEASURE AS MUCH TO WHAT WE DO NOT KNOW AS TO WHAT WE HAVE LEARNED BY OUR OWN REVIEWS. PART OF WHAT WE DO KNOW IS THAT THESE PROGRAMS REPRESENT A $12 TO $15 BILLION EXPOSURE TO THE GOVERNMENT AND THIS ALONE REQUIRES US TO BE CONCERNED. WE BELIEVE THAT TOP AGENCY MANAGEMENT MUST ALSO BE CONCERNED AND THAT A THOROUGH ACROSS-THE-BOARD REVIEW OF THESE PROGRAMS MUST BE DONE TO ANSWER SUCH QUESTIONS AS: ARE RESOURCES ADEQUATE TO DO THE JOB? ARE THE RESOURCES IN THE RIGHT PLACES? HAS THE ORGANIZATION OF AGENCY FUNCTIONS KEPT PACE WITH CHANGES IN THE MARKETPLACE? CAN

MANAGEMENT CONTROLS AND THE DELIVERY OF SERVICES BE IMPROVED AND MADE MORE EFFECTIVE? THE ADMINISTRATOR AND MANY OF THE LINE MANAGERS HAVE DEMONSTRATED THAT THEY ARE CONCERNED AND HAVE TAKEN STEPS TO ASSESS THESE OPERATIONS. AGAIN, WE HAVE BEEN ENCOURAGED AND IMPRESSED WITH THE QUALITY OF THE TWO STUDIES COMMISSIONED FROM IRVING BURTON ASSOCIATES, INC. AND ARE MOST ANXIOUS TO SEE THE RESULTS OF THE SECOND REVIEW. AS TO THE OIG'S OBLIGATIONS, WE RECOGNIZE THAT WE MUST MAKE A COMMITMENT AND PROVIDE THE SUPPORT TO ENSURE THAT ADEQUATE AUDIT COVERAGE IS PROVIDED TO ALL AGENCY FINANCIAL PROGRAMS.

## SMALL BUSINESS CAPITAL OWNERSHIP DEVELOPMENT

YOU HAVE ASKED ABOUT THE STATUS OF THE SMALL BUSINESS CAPITAL OWNERSHIP DEVELOPMENT PROGRAM AND THE IMPLEMENTATION OF THE REFORMS CONTAINED IN PUBLIC LAW 100-656. WHEN ONE CONSIDERS THAT THE TIMING OF THE REFORM LEGISLATION COINCIDED WITH THE CHANGE OF ADMINISTRATION, MANY POSITIVE STEPS HAVE BEEN TAKEN BY AGENCY MANAGERS IN THE LAST YEAR.

- FINAL REGULATIONS WERE IMPLEMENTED IN 1989;

- STANDARD OPERATING PROCEDURES ARE NOW BEING CIRCULATED FOR CLEARANCE PRIOR TO IMPLEMENTATION;

- TEN POSITIONS HAVE BEEN ESTABLISHED TO PROCESS 8(A) APPLICATIONS IN THE REGIONAL OFFICES;

- A FIRST EFFORT AT CLEARING UP AN ACCUMULATED BACKLOG OF APPLICATIONS IN THE SYSTEM WAS COMPLETED IN AUGUST 1989, WITH APPROXIMATELY 800 APPLICATIONS PROCESSED; A SECOND EFFORT IS NOW UNDERWAY TO PROCESS AN ADDITIONAL 400 APPLICATIONS;

- NEW APPLICATION FORMS WERE DEVELOPED AND CLEARED THROUGH OMB, AND WHILE I UNDERSTAND THAT THERE MAY HAVE BEEN SOME PROBLEMS, THEY HAVE NOW BEEN PRINTED AND DISTRIBUTED; AND

- A REORGANIZATION OF CENTRAL OFFICE 8(A) STAFF HAS BEEN PROPOSED.

OUR STAFF IS IN THE PROCESS OF REVIEWING THE DRAFT REVISED STANDARD OPERATING PROCEDURES AND WILL PROVIDE APPROPRIATE COMMENTS TO THE PROGRAM MANAGERS. AT THIS POINT, HOWEVER, IT IS REALLY TOO EARLY TO TELL HOW WELL THE REFORMS ARE WORKING OVERALL. WE EXAMINED OUR INVESTIGATION WORKLOAD AND FOUND THAT, WHILE WE HAVE HAD A SUBSTANTIAL INCREASE IN THESE CASES FROM 1986 (9 CASES) TO THE PRESENT (73 CASES), THE CASES FLOW FROM INCIDENTS THAT OCCURRED PRIOR TO ENACTMENT OF P.L. 100-656. THE 8(A) PROGRAM IS OUR SECOND LARGEST AREA OF INVESTIGATIVE ACTIVITY, ACCOUNTING FOR 26% OF OUR

INVESTIGATIVE TIME IN FY 1989. OUR EFFORTS RESULTED IN 13 INDICTMENTS, 26 CONVICTIONS, AND $11 MILLION IN DOLLAR ACCOMPLISHMENTS IN THIS PROGRAM. AGAIN, FOR REASONS ALREADY STATED, ONLY LIMITED AUDIT RESOURCES HAVE BEEN DEVOTED TO THIS PROGRAM, AND WE DO NOT HAVE MUCH AUDIT HISTORY ON IT.

WE ARE ALSO AWARE THAT THE GENERAL ACCOUNTING OFFICE IS REQUIRED BY P.L. 100-656 TO CONDUCT A COMPREHENSIVE REVIEW OF THE PROGRAM "COMMENCING WITHIN 180 DAYS OF THE ENACTMENT OF THE ACT AND CONCLUDING ON SEPTEMBER 30, 1991." REPRESENTATIVES FROM GAO MET WITH US SEVERAL MONTHS AGO TO COORDINATE FUTURE AUDITS. GAO HAS ADVISED US OF THEIR PLANS TO CONDUCT THE REQUIRED REVIEW, COMMENCING IN SEPTEMBER 1990, AND WE WILL ASSIST AND COOPERATE WITH GAO TO THE GREATEST POSSIBLE EXTENT.

## BUDGET AND STAFFING

I HAVE BEEN ASKED TO ADDRESS THE ADEQUACY OF THE FUNDING AND STAFFING AVAILABLE FOR THE OIG TO CARRY OUT ITS RESPONSIBILITIES UNDER LAW. THIS IS THE FIRST YEAR THAT THE OIG HAS OPERATED UNDER A SEPARATION APPROPRIATION ACCOUNT, AS PROVIDED BY THE IG ACT AMENDMENTS OF 1988. THIS TRANSITION, ALONG WITH GRAMM-RUDMAN ADJUSTMENTS AND ABSORPTION OF THE PAY RAISE, HAS MADE AN OTHERWISE TIGHT SITUATION WE MENTIONED PREVIOUSLY EVEN MORE DIFFICULT THIS YEAR. WE ANTICIPATED SOME OF THIS AND BEGAN A SELF-IMPOSED HIRING FREEZE AND PLACED TIGHT CONTROLS OVER ALL CONTROLLABLE EXPENDITURES

SUCH AS TRAVEL, TRAINING, AND CONTRACT SERVICES. IF IT HAD NOT BEEN FOR THESE ACTIONS, THE CONSEQUENCE OF WHICH IS THE 13 VACANCIES WE NOW HAVE, REPRESENTING 10% OF OUR AUTHORIZED STAFFING LEVEL, WE MOST ASSUREDLY WOULD HAVE HAD TO INSTITUTE A REDUCTION IN FORCE OR FURLOUGH.

## FY 1990 RESOURCE LEVEL

IT MIGHT APPEAR AT FIRST GLANCE THAT THE FY 1991 REQUESTED LEVEL OF $9.8 MILLION FOR THE OIG IS A SUBSTANTIAL INCREASE FROM OUR FY 1990 APPROPRIATED LEVEL OF $7.4 MILLION. IN REALITY, OUR $7.4 MILLION APPROPRIATION IS AN ACTUAL REDUCTION FROM THE $7.597 MILLION LEVEL AT WHICH WE ENDED FY 1989. FACED WITH RISING COSTS OVER WHICH WE HAVE NO CONTROL IN SUCH AREAS AS SALARY, BENEFITS, AND TRAVEL, WE MADE THE DECISION TO FREEZE ALL RECRUITMENT AND HIRING ACTIVITIES AND TIGHTLY MANAGE ALL OTHER EXPENSES AS WE ENTERED FY 1990 AND CONTINUED THROUGH THE FIRST QUARTER. THIS WAS DONE IN ORDER TO STAY WITHIN OUR APPROPRIATION WHILE MINIMIZING THE IMPACT ON OUR CURRENT STAFF AND ENSURING THAT ESSENTIAL WORK WAS CARRIED OUT. NEEDLESS TO SAY, THIS HAS HAD AN IMPACT ON OUR OPERATIONS.

THE POINT IS THAT OUR CURRENT APPROPRIATION OF $7.4 MILLION IS NOT SUFFICIENT TO FULLY FUND OUR CURRENT AUTHORIZED STAFFING LEVEL OF 131 PERMANENT AND 8 TEMPORARY EMPLOYEES, AND TO PROVIDE OUR AUDITORS AND INVESTIGATORS WITH THE NECESSARY TRAVEL AND OTHER FUNDS TO SUPPORT THEIR ACTIVITIES. AS AN EXAMPLE, AT THE FY 1990

FUNDING LEVEL OUR AUDITORS ARE ABLE TO SPEND APPROXIMATELY 10% OF THEIR TIME ON THE ROAD PERFORMING AUDITS, OR 2 DAYS PER MONTH. A MORE APPROPRIATE FUNDING LEVEL, GIVEN THE NATURE OF AUDIT WORK AS WELL AS GENERAL PRACTICE WITHIN THE AUDIT COMMUNITY, WOULD ALLOW OUR AUDITORS TO SPEND 25% OF THEIR TIME ON-SITE, OR 1 WEEK PER MONTH.

GIVEN THAT FULL FUNDING FOR OUR CURRENTLY AUTHORIZED STAFFING LEVEL WOULD APPROACH $8.7 MILLION, THE INCREMENTAL INCREASE TO THE $9.8 MILLION REQUESTED IN THE PRESIDENT'S BUDGET REPRESENTS A MODEST BUT, TO US, SIGNIFICANT RISE OF ABOUT 12% FOR FY 1991. THIS INCREASE, ALONG WITH THE 28 ADDITIONAL FTE, WOULD ENABLE US TO ADDRESS SOME CRITICAL AREAS THAT HAVE BEEN NEGLECTED IN THE PAST.

## INVESTIGATIONS WORKLOAD

ON THE INVESTIGATIONS SIDE, OUR JURISDICTION INCLUDES OVER 100,000 BORROWERS, 500 SBICS, 3,000 SECTION 8(A) FIRMS, 3800 PERMANENT SBA EMPLOYEES, A FLUCTUATING NUMBER OF TEMPORARY DISASTER EMPLOYEES, AND NUMEROUS OTHER ENTITIES, SUCH AS 56 SBDCS. TO HANDLE OUR INVESTIGATIVE WORKLOAD, WE CURRENTLY HAVE 31 CRIMINAL INVESTIGATORS AT THE FIRST-LINE SUPERVISORY LEVEL OR BELOW. IN ADDITION, THE RESOURCES AVAILABLE TO CONDUCT INVESTIGATIONS HAS DECLINED SINCE FY 1986 BY 21% FOR TRAVEL, WITH OVERTIME ALLOCATIONS OF $80,000 IN 1987 REDUCED TO A CURRENT LEVEL OF $20,000 FOR THE ENTIRE YEAR, A REDUCTION OF 75%.

OUR INVESTIGATIONS CASELOAD, ON THE OTHER HAND, HAS CONTINUED TO GROW. IN THE PAST FOUR YEARS, WE HAVE AVERAGED APPROXIMATELY 600 PIECES OF INFORMATION PER YEAR IN THE FORM OF COMPLAINTS CONCERNING AGENCY PROGRAMS OR EMPLOYEES. OF THAT NUMBER, APPROXIMATELY 210-220 ARE NUMBERED AS INVESTIGATIONS, ANOTHER 80-100 ARE REFERRED TO OTHER AGENCIES DUE TO STAFFING OR GEOGRAPHIC CONSIDERATIONS, AND THE REMAINDER ARE FILED FOR FUTURE REFERENCE. WE HAVE BEEN ABLE TO CLOSE APPROXIMATELY 170 CASES PER YEAR. WE HAVE ALSO EXPERIENCED INVENTORY BUILDUPS ON TWO OCCASIONS WHICH NECESSITATED WHOLESALE CLOSINGS AND REFERRALS TO OTHER AGENCIES IN ORDER TO KEEP THE CASELOAD MANAGEABLE.

AS A RESULT OF A STEADILY INCREASING WORKLOAD OF COMPLEX CASES, WE HAVE HAD TO CONTINUALLY REVISE OUR PRIORITIES AND CRITERIA FOR OPENING CASES. GENERALLY, CASES ARE SELECTED FOR INVESTIGATION BASED ON THE POTENTIAL FOR POSITIVE ACTION AS A RESULT OF THE EFFORTS OF THE SPECIAL AGENT. THE CURRENT CUTOFF FOR LOAN AND CONTRACT CASES IS A MINIMUM OF $100,000. WHILE NOT A HARD, FAST FIGURE IN ALL CASES, IT HAS BEEN DETERMINED TO BE A REASONABLE ATTEMPT TO CONTROL OUR INVENTORY. THE IMPACT ON AGENCY PROGRAMS THROUGH THE NECESSITY OF HAVING TO PRIORITIZE THE CASES CAN BE DEMONSTRATED BY THE FACT THAT IN FY 1989 WE HAD TO TURN DOWN 158 CASES BECAUSE THEY INVOLVED LOSSES OF LESS THAN $100,000 EACH. ALTHOUGH THE POTENTIAL FOR LOSS IS OBVIOUS, THERE IS ANOTHER NEGATIVE SIDE EFFECT IN HAVING TO IMPLEMENT SUCH A POLICY, AND THAT IS THE LOSS OF CONFIDENCE OF AGENCY EMPLOYEES IN OUR ABILITY TO

DEAL EFFECTIVELY WITH THE ALLEGATIONS OF FRAUD THEY REFER. WE RECEIVE CONSTANT FEEDBACK FROM MANAGERS AND EMPLOYEES THAT WE 'RARELY' DO ANYTHING WITH THE INFORMATION THEY SEND; THIS PERCEPTION COULD HAVE DEVASTATING EFFECTS IN THE FUTURE IF THIS FRUSTRATION RESULTS IN A BREAKDOWN IN THE REFERRAL PROCESS.

A LOOK AT OUR CURRENT INVENTORY FIGURES HELPS PUT THIS IN PERSPECTIVE. WE HAVE 210 ACTIVE CASES ON HAND REPRESENTING A POTENTIAL DOLLAR LOSS OF $590 MILLION. INCLUDED IN THESE CASES ARE 24 GRAND JURY INQUIRIES, 4 TASK FORCE ASSIGNMENTS, AND 20 INVESTIGATIONS EACH INVOLVING A POTENTIAL DOLLAR LOSS IN EXCESS OF $1 MILLION. IN ADDITION, THERE ARE APPROXIMATELY 80 CASES IN PENDING STATUS AWAITING TRIAL OR OTHER ACTION. IF WE OPENED NO NEW CASES, WE ESTIMATE THAT IT WOULD TAKE OVER TWO YEARS TO CLEAR JUST THE EXISTING INVENTORY.

## AUDIT WORKLOAD

ON THE AUDIT SIDE, MANDATED WORK, OR WORK WHICH WE ARE REQUIRED TO PERFORM BY LAW, REGULATION, OR DIRECTIVE, CONSUMES APPROXIMATELY TWO-THIRDS OF OUR CURRENT STAFF RESOURCES. OF THE ESTIMATED 9,000 AVAILABLE AUDIT STAFF DAYS, ABOUT 6,000 STAFF DAYS ARE NEEDED TO MEET NUMEROUS LEGAL REQUIREMENTS. AS A RESULT, ONLY APPROXIMATELY ONE-THIRD OF OUR AUDIT STAFF RESOURCES ARE AVAILABLE TO ADDRESS OIG, AGENCY, AND OTHER PRIORITIES AND TO PROVIDE COVERAGE TO SBA PROGRAMS AND PORTFOLIOS.

THE DIRECT EFFECT OF THIS HAS BEEN THAT, OVER THE PAST SEVERAL YEARS, IF THINGS HAD WORKED OUT IDEALLY, WE WOULD HAVE PERFORMED INTERNAL AUDITS OF PRIORITY AREAS ON A TEN-YEAR CYCLE. INCLUDED IN OUR PRIORITY AUDIT UNIVERSE ARE SUCH PROGRAMS AS THE MINORITY SMALL BUSINESS, BUSINESS LOAN PROCESSING AND SERVICING, AND DISASTER LOAN PROGRAMS, AS WELL AS AGENCY PROGRAMS THAT HAVE NEVER BEEN AUDITED. GIVEN THE NATURE OF THESE PROGRAMS AND THE SIZE OF THE AGENCY'S PORTFOLIO, OUR GOAL IS TO REDUCE THIS TO A THREE-YEAR CYCLE AND MAKE SURE THAT WORK IS COMPREHENSIVE AND PERFORMED ON A REGULAR SCHEDULE, RATHER THAN ON A "START-STOP" BASIS AS IN THE PAST, WHERE EVERYTHING HAS BEEN SUBORDINATED TO MANDATED WORK.

OUR EXTERNAL AUDIT PROGRAM, OTHER THAN FOR SBICS, DESERVES MORE ATTENTION. WITH THE SBIC EXAMINATION PROGRAM CURRENTLY CONSUMING ABOUT TWO-THIRDS (19 OF 31) OF THE AUDITOR STAFF YEARS ALLOCATED TO EXTERNAL AUDITS OF ENTITIES RECEIVING SBA ASSISTANCE, IN THE BEST OF CIRCUMSTANCES WE WOULD PERFORM OR COORDINATE AUDITS OF APPROXIMATELY 80 ENTITIES EACH YEAR. THIS REPRESENTS AUDIT COVERAGE OF A FRACTION OF THE EXTERNAL AUDIT UNIVERSE (EXCLUDING SBICS) OF APPROXIMATELY 273,800 AUDITABLE ENTITIES. THIS UNIVERSE IS MADE UP OF RECIPIENTS OF CONTRACTS, GRANTS, AND COOPERATIVE AGREEMENTS, CERTIFIED DEVELOPMENT COMPANIES, NON-BANK LENDERS, SURETY BOND GUARANTEE PROGRAM PARTICIPANTS, RECIPIENTS OF BUSINESS AND DISASTER LOANS, AND SECTION 8(A) CONTRACTORS. THESE AUDITS ARE CRITICAL TO IMPROVING PROGRAM INTEGRITY AND ASSURING ADEQUATE

INTERNAL CONTROLS, WHERE OUR SERVICE CAN REALLY HELP AGENCY MANAGERS IN THEIR EFFORT TO DO A BETTER JOB.

FY 1991 REQUEST

THE PRESIDENT'S FY 1991 BUDGET REQUEST FOR THE OIG RECOGNIZES THE LIMITATIONS THAT OUR CURRENT LEVEL OF RESOURCES PLACES ON OUR ABILITY TO COPE WITH OUR WORKLOAD. IT ADDRESSES OUR NEED FOR ADDITIONAL RESOURCES IN THE CRITICAL AREAS OF PERSONNEL COMPENSATION, TRAVEL, AND CONTRACT SERVICES. I FULLY SUPPORT THE PRESIDENT'S REQUEST AND BELIEVE THAT, IF ENACTED, IT WILL ENABLE US TO PROVIDE BETTER AUDIT AND INVESTIGATIVE COVERAGE OF CRITICAL PROGRAM AREAS.

ON THE AUDIT SIDE, WE WOULD BE ABLE TO INCREASE OUR LEVEL OF EFFORT BY: (1) PERFORMING 4 PRIORITY ADP AUDITS OF AUTOMATED SYSTEMS SUCH AS THE SURETY BOND LOAN ORIGINATION AND DISBURSEMENT SYSTEM, THE LOAN ACCOUNTING AND COLLECTION SYSTEM, AND THE LOAN SERVICING AND DEBT COLLECTION SYSTEM; (2) DEVOTING 2 ADDITIONAL STAFF YEARS TO FINANCIAL AUDITS, INCLUDING A FINANCIAL STATEMENT AUDIT OF 1 SBA FUND AND AUDITS OF SPECIFIC FINANCIAL TRANSACTIONS WITH A POTENTIAL FOR LOSS OR FRAUD; (3) CONDUCTING 25-30 ADDITIONAL EXTERNAL AUDITS WHICH COULD RESULT IN $4.3 MILLION IN SAVINGS, BASED ON PAST PRODUCTIVITY; AND (4) INCREASING THE NUMBER OF STAFF YEARS DEVOTED TO FMFIA ACTIVITIES TO 1.5 YEARS.

ON THE INVESTIGATIONS SIDE, WE WOULD BE ABLE TO ESTABLISH AN INVESTIGATIVE PRESENCE IN REGION I, WHERE WE CURRENTLY HAVE NO SPECIAL AGENTS ASSIGNED. WE WOULD ALSO BE ABLE TO BOLSTER OUR ONE-PERSON POST OF DUTY STATIONS IN CITIES SUCH AS LOS ANGELES (WHICH SERVES THE LARGEST SBA DISTRICT OFFICE IN THE COUNTRY) AND SEATTLE (WHICH SERVES ALL OF REGION X). THE ADDITIONAL INVESTIGATOR POSITIONS WOULD ENABLE US TO HANDLE OUR PROJECTED CASELOAD OF 370 CASES, AS WELL AS TO INITIATE SUCH PROACTIVE PROJECTS AS SELECTED OPERATIONAL REVIEWS (SORS) WHICH HAVE BEEN NEGLECTED FOR THE PAST SEVERAL YEARS DUE TO STAFFING AND RESOURCE CONSTRAINTS. FINALLY, WE WOULD BE ABLE TO MEET OUR GOAL OF PROVIDING FRAUD AWARENESS BRIEFINGS TO ONE-THIRD OF ALL SBA EMPLOYEES ANNUALLY, AN EFFORT WHICH WE BELIEVE IS CRUCIAL IN HELPING THEM TO RECOGNIZE AND HANDLE INTEGRITY-THREATENING SITUATIONS.

## GOALS AND OBJECTIVES

FINALLY, I HAVE BEEN ASKED TO ADDRESS THE GOALS AND OBJECTIVES OF THE OFFICE FOR THE COMING YEARS. AS YOU MAY GUESS, OUR FUTURE DIRECTIONS WILL FLOW FROM THE ACCOMPLISHMENTS AND PROBLEMS I HAVE ALREADY DISCUSSED. IN A BROAD SENSE, WE HAVE THREE OVERARCHING GOALS WHICH WE CONTINUALLY STRIVE TO ATTAIN IN OUR ACTIVITIES. THESE LONG-RANGE GOALS ARE:

- MAXIMIZE AGENCY USE OF OIG PRODUCTS AND INFORMATION.

- USE OIG RESOURCES IN THE MOST EFFECTIVE MANNER POSSIBLE.

- EMPHASIZE PROFESSIONALISM AND CAREER DEVELOPMENT ACTIVITIES.

AS WE MOVE THROUGH FY 1990 AND BEYOND, WE WILL BE PAYING PARTICULAR ATTENTION TO A NUMBER OF SPECIFIC OBJECTIVES THAT WILL FURTHER THESE LONG-TERM GOALS. IT IS CRITICAL THAT WE CONTINUE TO REFINE AND IMPROVE OUR AUDIT PROGRAM TO ENSURE EVEN CLOSER ADHERENCE TO THE COMPTROLLER GENERAL'S AUDIT STANDARDS. THIS WILL ENTAIL:

- OBTAINING STATUTORY RELIEF FROM THE BIENNIAL SBIC EXAMINATION REQUIREMENT TO ALLOW FOR A MORE FLEXIBLE AND REASONED APPROACH TO THIS, AS WELL AS ALL, AUDIT WORK. WE HAVE CONSISTENTLY ARGUED THAT SECTION 687(B) OF THE SMALL BUSINESS INVESTMENT ACT BE CHANGED FROM "ANNUAL" (NOW "BIENNIAL") TO "PERIODIC EXAMINATIONS IN ACCORDANCE WITH THE INSPECTOR GENERAL ACT."

- UPDATING OUR CRITERIA-BASED PLANNING PROCESS FOR SBIC AUDITS, AND IMPLEMENTING THIS PROCESS IN OUR PLANNING FOR OTHER AUDITS;

- FULLY IMPLEMENTING AN EFFECTIVE QUALITY ASSURANCE PROGRAM FOR NONFEDERAL AUDIT WORK, AS REQUIRED BY STATUTE AND RECOMMENDED BY GAO;

- IMPROVING INTERNAL AUDIT COVERAGE OF MAJOR PROGRAMS AND SUPPORT ACTIVITIES;

- WORKING WITH AGENCY MANAGEMENT TO ADOPT AUDIT TRACKING AND RESOLUTION PROCEDURES TO IMPLEMENT THE REQUIREMENTS OF THE IG ACT AMENDMENTS OF 1988; AND

- IMPROVING THE FORM AND CONTENT OF OUR AUDIT REPORTS TO MORE CLOSELY ADHERE TO GAO AUDIT STANDARDS.

ON THE INVESTIGATIONS SIDE, WE WILL CONTINUE TO PURSUE INITIATIVES SUCH AS:

- OBTAINING STATUTORY LAW ENFORCEMENT AUTHORITY FOR OUR INVESTIGATORS, AS PART OF OUR EFFORTS TO PROMOTE PROFESSIONALISM, BE COMPETITIVE WITHIN THE COMMUNITY, AND ENSURE THE SAFETY OF BOTH THOSE WHO WORK FOR US AND THOSE WE HAVE AN OBLIGATION TO SUPPORT AND PROTECT (CURRENT LEGISLATION INCLUDES S. 2080 AND H.R. 4149, WHICH WERE RECENTLY INTRODUCED BY SENATOR RUDY BOSCHWITZ AND CONGRESSMAN HARLEY O. STAGGERS, RESPECTIVELY, PRIMARILY AS A RESULT OF THE FINDINGS OF THE NATIONAL ADVISORY COMMISSION ON LAW ENFORCEMENT);

- LEVERAGING THE SERVICES OF OTHER INVESTIGATIVE AGENCIES, SUCH AS THE FBI, DCIS, AND OTHER OIGS, THROUGH JOINT INVESTIGATIONS AND DIRECT REFERRALS;

- WORKING CLOSELY WITH AGENCY MANAGEMENT TO PROMOTE INTEGRITY AMONG EMPLOYEES AND PARTICIPANTS IN SBA PROGRAMS THROUGH A SERIES OF TRAINING SEMINARS, AWARENESS PRESENTATIONS, AND RELATED INITIATIVES; AND

- INITIATING PROACTIVE REVIEWS OF POTENTIAL HIGH RISK AREAS TO IDENTIFY THOSE WEAKNESSES WHICH COULD BE USED TO ALLOW AN EMPLOYEE OR PARTICIPANT TO ABUSE THE SYSTEM FOR ILLEGAL GAIN.

FROM AN OVERALL MANAGEMENT PERSPECTIVE, WE WILL BE ASSESSING OUR ORGANIZATIONAL STRUCTURE AND STAFFING PATTERNS TO ENSURE THAT RESOURCES ARE BEING DIRECTED WHERE THEY WILL BE USED MOST EFFECTIVELY. INITIATIVES IN THIS AREA WOULD INCLUDE:

- INCREASING OUR FIELD AUDIT AND INVESTIGATIVE STAFF, INCLUDING OPENING ADDITIONAL OFFICES IN AREAS WHERE WE CURRENTLY LACK AN INVESTIGATIVE PRESENCE, SUCH AS REGION I;

- RECRUITING AUDITORS AND INVESTIGATORS TO FILL CRITICAL SKILL POSITIONS (SUCH AS ADP AUDITORS AND CPAS) AS FUNDS BECOME AVAILABLE; AND

- EMPHASIZING THE TRAINING AND PROFESSIONAL DEVELOPMENT OF OUR STAFF TO ENSURE THAT QUALITY WORK IS PRODUCED, AS WE HAVE A CONTINUING OBLIGATION TO CONGRESS, THE AGENCY, THE PUBLIC, AND OURSELVES TO SEE THAT OUR AUDITORS AND INVESTIGATORS ARE UP-TO-DATE AND TECHNICALLY PROFICIENT IN THE NEWEST DEVELOPMENTS IN COMPLEX AGENCY FINANCIAL AND ASSISTANCE PROGRAMS, LAW ENFORCEMENT TECHNIQUES, COMPUTERIZED PROCESSES, AND LEGAL REQUIREMENTS.

## KMIEC OPINION

ONE FINAL THING BEFORE CLOSING. I UNDERSTAND, MR. CHAIRMAN, THAT YOU ARE AWARE OF AND CONCERNED ABOUT A DEPARTMENT OF JUSTICE LEGAL OPINION, COMMONLY REFERRED TO AS THE "KMIEC" OPINION, WHICH PLACES LIMITATIONS ON THE INVESTIGATIVE JURISDICTION OF THE INSPECTOR GENERAL OF THE DEPARTMENT OF LABOR. THE OPINION HAS NO KNOWN ADVERSE IMPACT ON THE SMALL BUSINESS ADMINISTRATION INSPECTOR GENERAL, AT THE MOMENT, BECAUSE THE CURRENT LEGAL WISDOM IS THAT WE OBTAINED OUR JURISDICTIONAL AUTHORITIES AND OPERATIONAL RESPONSIBILITIES BY THE TRANSFER PROVISIONS OF THE IG ACT OF 1978.

I AM CONCERNED NONETHELESS BECAUSE: (1) THE OPINION IS REPORTEDLY ONLY APPLICABLE TO THE DEPARTMENT OF LABOR, BUT HAS BEEN EMPLOYED AS A CONDITION FOR THE DEPARTMENT OF JUSTICE'S APPROVAL OF OUR REQUESTS FOR U.S. MARSHAL DEPUTATION; (2) CERTAIN SBA PROGRAM OFFICIALS HAVE ASSERTED THE BELIEF THAT THE OPINION COULD BE PROPERLY APPLIED TO LIMIT OUR AUTHORITY TO AUDIT CERTAIN AGENCY PROGRAMS; (3) IF YOU CAN ACCEPT THE POSITION THAT FEDERAL MONEY AND/OR AN AGENCY EMPLOYEE MUST BE INVOLVED IN ORDER FOR AN INSPECTOR GENERAL TO HAVE JURISDICTION, LANGUAGE NOT EVEN USED IN THE LAW, WHILE THE IG ACT SPEAKS TO JURISDICTION IN TERMS OF THE AGENCY'S PROGRAMS AND ACTIVITIES, IT IS NOT A LONG JUMP TO NEXT CONCLUDE THAT IT ALSO APPLIES TO MY OFFICE; AND (4) THE OPINION RAISES AN ISSUE AS TO THE PERSONAL TORT LIABILITY OF INDIVIDUAL INVESTIGATORS ASSIGNED TO A CASE SHOULD THE DEPARTMENT OF JUSTICE LATER QUESTION THE INVESTIGATIVE JURISDICTION AND DECLINE LEGAL REPRESENTATION FOR THE INVESTIGATOR. IN VIEW OF ALL THESE ISSUES, THE ATTENTION AND CONCERNS OF THE CONGRESS TO SEE THAT A TIMELY RESOLUTION IS ACHIEVED ARE APPROPRIATE.

I APPRECIATE THE OPPORTUNITY TO APPEAR TODAY AND PRESENT THESE VIEWS, AND I HOPE THAT MY COMMENTS HAVE BEEN HELPFUL TO YOU. I WILL BE PLEASED TO RESPOND TO ANY QUESTIONS YOU MAY HAVE AT THIS TIME.

The CHAIRMAN. Inspector General Gillum, first of all let me say that I have read your statement, and it is a very comprehensive one. It throws up lots of red flags that causes me, and I am sure other Members of the Committee who are or will become aware of some of these problems, it causes us considerable concern. But just as quickly as we can, we want an oversight hearing on SBICs and just general internal policies that you have been involved in in auditing.

I am especially concerned about situations such as the one you describe here in New Jersey about a couple of SBICs, how those liquidations were handled, and so on. How they were not handled, I should say.

But I find your statement very comprehensive and most interesting, and it makes me very pleased and proud of Tom Eagleton because, when he was a Senator, he was the one who passed the legislation for the inspectors general. It has been a godsend to Members of Congress. It puts us on kind of an even footing. Things are not so easily concealed, and when I see SBA, as you point out here, maybe losing $10 million just on one liquidation, that is a source of considerable concern, but the way we spend money around here, $10 million is not much, but to a country boy like me, as W.C. Fields says, "It ain't bean bag either," particularly when it is unnecessary.

Mr. GILLUM. It is more than our annual budget, so it is a lot of money to me, sir.

The CHAIRMAN. That is right. It is more than OIG's annual budget. So in any event, rather than keep you here this afternoon and go through this whole thing, I want more time to digest your statement, also. And we will certainly want you back here for that oversight hearing to go into some depth, and probably will sit down and visit with you before that hearing, because I want that to be a meaningful hearing.

Mr. GILLUM. I would appreciate having the opportunity to meet with you ahead of time because there are a number of things with respect to some ongoing programs that I would not like to discuss publicly at this time.

The CHAIRMAN. We may be required. I do not know what the rules are. I will just have to have staff check that out, but I suspect that we may want a closed hearing, if that can be accommodated to make sure that people are not impugned, necessarily, because we may be talking about criminal activity and we certainly do not want, you know, as an old trial lawyer, I believe in protecting people's rights, but I really want to delve into this in considerable detail.

Let me say, you know when I was Governor, I was only 44 years old when I started out, but I had done a lot of things. I had practiced law and run some businesses and owned a cemetery and a whole bunch of other things that really stood me in good stead.

And I knew initially that my success as Governor in implementing my policies and getting the legislative cooperation, and getting the people behind my programs. was going to be due, as much as anything, to the things that did not happen as well as the things that did.

And we spent an inordinate amount of time—I did not have an inspector general, but I had a lot of people in my office going out to check virtually every allegation. As you know, I got allegations from jealous wives and everything else in that office.

But we spent as much time trying to make sure that we appointed good people and honest people and making sure that there was no hanky panky, no big scandals and that sort of thing, because, once that starts in, you will lose your credibility and you cannot do anything else. You just have to manage the scandals. You cannot really be positive and do the things that need to be done.

I must say that was the wisest decision I ever made. We had a scandal-free 4 years and we were able to get about 98 percent of what I asked for through the legislature.

And so, these inspectors general, not just here but all over Government, are really performing yeoman service and being a tremendous help to us, and I think over the long haul, they are going to save the taxpayers of this country billions of dollars.

But with having said that, Inspector General Gillum, I will probably ask you to come to the office and visit with me before that hearing. We will try to figure out exactly how we are going to handle it.

Mr. GILLUM. We look forward to that, Mr. Chairman.

The CHAIRMAN. Thank you very much. We will stand in recess, subject to the call of the Chair.

[Whereupon, at 4:08 p.m., the hearing was recessed.]